



1977

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## Recommended Citation

Roy Ryden Anderson, *Failure of Essential Purpose and Essential Failure on Purpose: A Look at Section 2-719 of the Uniform Commercial Code*, 31 Sw L.J. 759 (1977)

<https://scholar.smu.edu/smulr/vol31/iss4/1>

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# FAILURE OF ESSENTIAL PURPOSE AND ESSENTIAL FAILURE ON PURPOSE: A LOOK AT SECTION 2-719 OF THE UNIFORM COMMERCIAL CODE

by

Roy Ryden Anderson\*

OF all the delightful mysteries and open-ended questions posed by article 2 of the Uniform Commercial Code, some of the most perplexing surely arise from that myriad of sections which establish the standards by which one may disclaim, limit, or exculpate liability.<sup>1</sup> This Article will concern itself primarily with two such questions, both relating to limitations on liability under the Code. First, under what sets of circumstances have the courts found "an exclusive or limited remedy to fail of its essential purpose" under section 2-719 of the Code?<sup>2</sup> Secondly, when an exclusive remedy has been found to fail of its essential purpose under 2-719, does an independent consequential damage disclaimer remain valid?<sup>3</sup> The efficacy of a consequential damage disclaimer is obviously of particular importance to the party to the contract, usually the seller, who stands to benefit from the disclaimer. Potential liability for consequential damages is enormous in most commercial contexts,<sup>4</sup> and accordingly, the consequential damage disclaimer will often be more important than any other liability disclaimers which may be part of the contract. Both questions which this Article addresses have been the subject of considerable litigation in recent years, and the factual contexts giving rise to the litigation and the reasoning of the respective courts are sufficiently varied and interesting to be worthy of close analysis.

At the outset an important point should be made. When considering a question involving disclaimers or liability limitations a plethora of Code provisions come into play. One is never safe in concluding without careful analysis that certain provisions apply to the exclusion of others. At the risk of oversimplification, the broad theme underlying the Code provisions seems to be that one who wishes to buffer responsibility for breach may choose among at least three related alternatives: (1) avoiding liability altogether by making a warranty disclaimer or by carefully delimiting the warranties made;<sup>5</sup> (2) limiting liability by choosing one or more "adequate"

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1. These three terms presumably cover the bases. Herein, "disclaims" and its cognates are generally used to refer to warranty disclaimers. "Limit" refers to any number of methods, e.g. constricting available remedies, of narrowing, as opposed to disclaiming, liability. "Exculpate" refers to disclaimers of tort liability which are generally outside the scope of this Article.

2. U.C.C. § 2-719(2) provides: "Where circumstances cause an exclusive or limited remedy to fail of its essential purpose, remedy may be had as provided in this Act."

3. U.C.C. § 2-719(3) provides in part: "Consequential damages may be limited or excluded unless the limitation or exclusion is unconscionable . . . ."

4. Mainly in the form of lost profits.

5. See U.C.C. § 2-316, quoted in note 8 *infra*.

exclusive remedies;<sup>6</sup> (3) making a guess at potential liability in the event of breach by liquidating anticipated damages, with the hope of limiting liability to the amount forecasted.<sup>7</sup> Thus, although our analysis would ostensibly involve a remedy limitation in the form of an exclusive remedy, to which 2-719(1) would apply, the failure of an exclusive remedy, covered by 2-719(2), and the continued validity of a consequential damage disclaimer under 2-719(3), other sections of the Code are too closely related to be ignored. One of the most obvious is warranty disclaimers under section 2-316, that curious section which requires disclaimers to be carefully brewed with precise ingredients of "merchantability," or sometimes "as is," and perhaps a little abracadabra in writing on occasion, carefully melded in a conspicuous manner, all in a pot supported by that most laughable witchery of contract law that people usually read the documents they sign.<sup>8</sup> Indeed, subsection (4) of 2-316 expressly recognizes the close relationship between warranty disclaimers and remedy limitations.<sup>9</sup>

The Code provisions on liquidated damages under section 2-718<sup>10</sup> may also become relevant; indeed, the prefatory language to 2-719<sup>11</sup> on remedy limitations expressly recognizes the nexus between exclusive remedy limitations and liquidated damage provisions. A liquidated damage provision is, after

6. See U.C.C. § 2-719(1) in the text accompanying notes 20-21 *infra*.

7. See U.C.C. § 2-718(1), quoted in note 10 *infra*.

8. U.C.C. § 2-316 provides:

(1) Words or conduct relevant to the creation of an express warranty and words or conduct tending to negate or limit warranty shall be construed wherever reasonable as consistent with each other; but subject to the provisions of this Article on parol or extrinsic evidence (Section 2-202) negation or limitation is inoperative to the extent that such construction is unreasonable.

(2) Subject to subsection (3), to exclude or modify the implied warranty of merchantability or any part of it the language must mention merchantability and in case of a writing must be conspicuous, and to exclude or modify any implied warranty of fitness the exclusion must be by a writing and conspicuous. Language to exclude all implied warranties of fitness is sufficient if it states, for example, that 'There are no warranties which extend beyond the description on the face hereof.'

(3) Notwithstanding subsection (2)

(a) unless the circumstances indicate otherwise, all implied warranties are excluded by expressions like 'as is', 'with all faults' or other language which in common understanding calls the buyer's attention to the exclusion of warranties and makes plain that there is no implied warranty; and

(b) when the buyer before entering into the contract has examined the goods or the sample or model as fully as he desired or has refused to examine the goods there is no implied warranty with regard to defects which an examination ought in the circumstances to have revealed to him; and

(c) an implied warranty can also be excluded or modified by course of dealing or course of performance or usage of trade.

(4) Remedies for breach of warranty can be limited in accordance with the provisions of this Article on liquidation or limitation of damages and on contractual modification of remedy (Sections 2-718 and 2-719).

9. *Id.*

10. U.C.C. § 2-718(1) provides:

Damages for breach by either party may be liquidated in the agreement but only at an amount which is reasonable in the light of the anticipated or actual harm caused by the breach, the difficulties of proof of loss, and the inconvenience or nonfeasibility of otherwise obtaining an adequate remedy. A term fixing unreasonably large liquidated damages is void as a penalty.

11. "Subject to the provisions of subsection (2) and (3) of this section *and of the preceding section on liquidation and limitation of damages* . . . ." U.C.C. § 2-719(1) (emphasis added).

all, always intended to be a type of exclusive remedy,<sup>12</sup> and the question will arise as to whether the validity of the provision is to be determined as a liquidated damage provision under the standards of 2-718, which are concerned primarily with events at the time of contracting,<sup>13</sup> or as an exclusive remedy under the standards of 2-719(2), which are concerned primarily with subsequent events.<sup>14</sup>

Nevertheless, before subjecting a contractual provision to the standards for liquidated damages under 2-718(1), rather than to the general standards for exclusive remedies under 2-719(1), one must be certain that the contractual provision is intended to liquidate damages. Form is not always telling. Assume that a buyer enters into an agreement with a seller for the sale, installation, and monitoring of a burglar alarm system. The agreement contains a liquidated damage clause stating that in the event of any failure in the goods or services the seller will be liable for \$50 as stipulated damages but not as a penalty. Obviously this clause in terms of function is more a limitation of liability than a liquidation of damages. The buyer would presumably not go to the trouble and expense of such a contract to protect assets of no more than \$50. Assuming for the moment that article 2 of the Code is applicable to the transaction, the clause may nevertheless be valid, not as an attempt to liquidate damages under 2-718(1) "at an amount which is reasonable in the light of the anticipated or actual harm," but as a proper measure to "limit or alter" damages under 2-719(1).<sup>15</sup> It is worth noting that 2-718(1) invalidates as a penalty "a term fixing unreasonably large liquidated damages"; it says nothing about unreasonably small liquidated damages, presumably regarding them as subject to the standards of the following section for limitations of liability.<sup>16</sup>

Other Code sections may also impact upon extensions of our analysis. Section 1-204 of the Code prohibits manifestly unreasonable time limitations. Section 2-302 on unconscionability can be all pervasive,<sup>17</sup> especially in

12. See *Farmers Union Grain Terminal Ass'n v. Nelson*, 223 N.W.2d 494, 17 UCC Rep. Serv. 139 (N.D. 1974).

13. There is little doubt, however, that subsequent events can be relevant under 2-718(1), because the provision validates liquidated damage provisions which are "reasonable in the light of the anticipated or actual harm." Curiously, 2-718(1), by using the conjunction "or" expands rather than restricts the opportunity to validate liquidated damage provisions. It seems likely, however, that the primary focus will remain, as under pre-Code law, on anticipated rather than actual damages. See *Jaquith v. Hudson*, 5 Mich. 123 (1858). See also 5 CORBIN ON CONTRACTS §§ 1058-1062 (1964). In *Bethlehem Steel Co. v. City of Chicago*, 234 F. Supp. 726 (N.D. Ill. 1964), the court interpreted 2-718(1) to uphold a liquidated damage provision which was a reasonable estimate at the time of the making of the contract of anticipated damages even though no actual damages were suffered. But see *Unit Vending Corp. v. Tobin Enterprises*, 194 Pa. Super. Ct. 470, 168 A.2d 750 (1961), which applies an odd reading to 2-718(1) in holding a liquidated damage provision voidable if "subsequently adjudged unreasonable in the light of either anticipated or actual harm." 168 A.2d at 751.

14. See text accompanying notes 25-27 *infra*.

15. See *Better Food Mkts., Inc. v. American Dist. Tel. Co.*, 40 Cal. 2d 179, 253 P.2d 10 (1953); *Zurich Ins. Co. v. Kings Indus., Inc.*, 255 Cal. App. 2d 919, 63 Cal. Rptr. 585 (1967). The preface to 2-719(1) recognizes that liquidated damage provisions under 2-718(1) may function to limit as well as liquidate damages. See note 11 *supra*.

16. Cf. U.C.C. § 2-718, Comment 1 (unreasonably small liquidated damage provisions may also be invalid under the Code provision against unconscionable contracts). See U.C.C. § 2-302(1), quoted in note 66 *infra*.

17. There is respectable authority for the proposition that 2-302 is not "all pervasive" throughout art. 2. For example, it has been persuasively argued that a warranty disclaimer that meets the "clear, specific and anything but easy-to-meet standards" of 2-316 cannot be

overturning provisions oppressive to consumers toward whom courts are becoming increasingly protective. Further, law external to the Code, such as the rules pertaining to negligent breach of contract, pure negligence, or heaven forbid, strict liability, may be applicable. Finally, the recently enacted federal legislation, the Magnuson-Moss Act<sup>18</sup> on consumer product warranties, cannot be ignored. With these caveats, however, our focus is primarily on section 2-719.<sup>19</sup>

### I. REMEDY LIMITATIONS GENERALLY

Section 2-719(1) grants to the parties a broad-based permission to *limit* or *alter*<sup>20</sup> their remedies. It provides:

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unconscionable under 2-302. Leff, *Unconscionability and the Code—The Emperor's New Clause*, 115 U. PA. L. REV. 485, 523, 516-28 (1967). See also 1 REPORT OF THE NEW YORK LAW REVIEW COMMISSION FOR 1955, at 586. Most commentators and several courts, however, have reasoned to the contrary. See, e.g., J. WHITE & R. SUMMERS, HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE 386-92 (1972); Ellinghaus, *In Defense of Unconscionability*, 78 YALE L.J. 757, 793-803 (1969); Fahlgren, *Unconscionability: Warranty Disclaimers and Consequential Damage Limitations*, 20 ST. LOUIS U.L.J. 435, 436-45 (1976).

18. Magnuson-Moss Warranty—Federal Trade Commission Improvement Act, 15 U.S.C. §§ 2301-2312 (Supp. V 1975). Although pertinent provisions of the Magnuson-Moss Act will be noted from time to time, the Act is beyond the scope of this Article which is concerned with 2-719 of the Uniform Commercial Code. Nevertheless, the Magnuson-Moss Act does supplant 2-719 with respect to most consumer transactions. And many of the cases discussed below do involve the consumer context; e.g., several of the cases dealing with the continued validity of the exclusive remedy of repair or replacement of defective parts arise in connection with consumers' automobiles. It should be apparent, however, that although such cases in the future will fall within the scope of the Magnuson-Moss Act, the analysis used by the courts in these cases will be of continuing validity in transactions between commercial entities involving non-consumer goods.

The Magnuson-Moss Act, interestingly enough, is not limited to consumer transactions. The Act governs "consumer products" which are defined to include "any tangible personal property which is distributed in commerce and which is normally used for personal, family, or household purposes." 15 U.S.C. § 2301(1) (Supp. V 1975). Thus, a sale of a household vacuum cleaner to a business entity would be governed by the Act. However, the Federal Trade Commission Regulations exclude "products which are purchased solely for commercial or industrial use" from the rules governing disclosure of written warranty terms and presale availability of written warranty terms. 16 C.F.R. §§ 701.1(b), 702.1(b) (1975).

Under the Magnuson-Moss Act there is no requirement that sellers warrant their products in writing or otherwise. If a consumer product costing more than \$10 is warranted, however, the warranty must be designated as either "full" or "limited." Under § 2304, to qualify as a "full" warranty four standards must be met: (1) the minimum remedy given by a warrantor must be to repair or otherwise correct any defect or other failure of the product to conform to the warranty; (2) no limitation can be placed on the duration of any implied warranty on the product; (3) any exclusion or limitation of consequential damages must conspicuously appear on the face of the warranty; (4) if the warrantor is unsuccessful after a reasonable number of attempts in remedying a defect, the consumer must be allowed to elect either a refund of the purchase price or a replacement of the product. 15 U.S.C. §§ 2304(a)(1)-(4) (Supp. V 1975).

Perhaps most provocatively, the Act disallows a warrantor who extends a written warranty to disclaim any implied warranties. *Id.* § 2308(a). Nevertheless, if only a "limited" warranty is given, the duration of implied warranties can be limited to that of the express warranty. *Id.* § 2308(b).

19. For a broader treatment of contractual disclaimers, limitations of liability, and exculpatory clauses under the Uniform Commercial Code see Fahlgren, *Unconscionability: Warranty Disclaimers and Consequential Damage Limitations*, 20 ST. LOUIS U.L.J. 435 (1976); Moye, *Exclusion and Modification of Warranty Under the UCC—How To Succeed in Business Without Being Liable for Not Really Trying*, 46 DENVER L.J. 579 (1969); Weintraub, *Disclaimer of Warranties and Limitation of Damages for Breach of Warranty Under the UCC*, 53 TEXAS L. REV. 60 (1974). For a different perspective of 2-719 see Eddy, *On the "Essential" Purposes of Limited Remedies: The Metaphysics of UCC Section 2-719(2)*, 65 CALIF. L. REV. 28 (1977). Unfortunately, Professor Eddy's interesting article was published in time to allow me only piecemeal, rather than integrated, plagiarism.

20. As Professors White and Summers point out: "In actual practice, however, the section is most often invoked to limit the buyer's remedies . . . ." J. WHITE & R. SUMMERS, *supra*

(1) Subject to the provisions of subsections (2) and (3) of this section and of the preceding section on liquidation and limitation of damages,

- (a) the agreement may provide for remedies in addition to or in substitution for those provided in this Article and may limit or alter the measure of damages recoverable under this Article, as by limiting the buyer's remedies to return of the goods and repayment of the price or to repair and replacement of non-conforming goods or parts; and
- (b) resort to a remedy as provided is optional unless the remedy is expressly agreed to be exclusive, in which case it is the sole remedy.<sup>21</sup>

The contract draftsman is presented by text and comment with a number of hurdles in concocting a remedy limitation under 2-719. Perhaps least important in commercial contexts, the limitation clause must avoid that hopelessly undefinable pitfall of unconscionability. The other party must be left with a "minimum adequate remedy" or a "fair quantum of remedy." Comment 1 to 2-719 sets the tone:

[I]t is of the very essence of a sales contract that at least minimum adequate remedies be available. If the parties intend to conclude a contract for sale within this Article they must accept the legal consequence that there be at least a fair quantum of remedy for breach of the obligations or duties outlined in the contract. Thus any clause purporting to modify or limit the remedial provisions of this Article in an unconscionable manner is subject to deletion . . . .<sup>22</sup>

Further, as the text of 2-719(1) provides, any remedy stated is assumed to be cumulative unless expressly stated to be exclusive.<sup>23</sup> Quite obviously these standards are for the most part rather vague, presumably with a calculation toward providing courts with wide discretion in determining the validity of remedy limitations. The penalty for failure to meet the standards is absolute because "in that event the remedies made available by this Article are applicable as if the stricken clause had never existed."<sup>24</sup> For our purposes, however, the assumption is that the draftsman has done his job well by brewing his concoction in a manner palatable to the courts.

Nevertheless, the validity of the clause may fall victim to intervening circumstances. Subsection (2) of 2-719 provides the warning: "Where circumstances cause an exclusive or limited remedy to fail of its essential purpose, remedy may be had as provided in this Act."<sup>25</sup> It is important to understand that the language of the subsection "is not concerned with arrangements which were oppressive at their inception, but rather with the application of an agreement to novel circumstances not contemplated by the

note 17, at 376. The reported decisions overwhelmingly bear this out. Accordingly, this Article often assumes when referring to 2-719 that a remedy limitation is involved and that it is the seller rather than the buyer who will benefit by the limitation.

21. U.C.C. § 2-719(1).

22. U.C.C. § 2-719, Comment 1.

23. U.C.C. § 2-719(1)(b). The language necessary to render a remedy exclusive can be problematic. *Compare* *Evans Mfg. Corp. v. Wolosin*, 1 UCC Rep. Serv. 193 (Pa. C.P. 1957), with *Ford Motor Co. v. Reid*, 250 Ark. 176, 465 S.W.2d 80, 8 UCC Rep. Serv. 985 (1971).

24. U.C.C. § 2-719, Comment 1.

25. U.C.C. § 2-719(2).

parties."<sup>26</sup> Comment 1 to 2-719 would seem to make this clear with language to the effect that the subsection applies when "an apparently fair and reasonable clause because of circumstances fails in its purpose . . . ."<sup>27</sup> Nevertheless, as we shall see, the courts at times have not limited the application of 2-719(2) to clauses valid at their inception, thereby muddying unnecessarily the already murky waters of the subsection.

Regardless, however, of whether a particular court has recognized that the scope of 2-719(2) is concerned only with unforeseen subsequent circumstances, it has been suggested that all of the reported decisions relying on the subsection can be classified under two general fact paradigms: (1) cases in which defects in the goods are latent and not discoverable upon receipt of shipment and reasonable inspection; and (2) cases in which the seller or other party is required to provide a remedy but, by its action or inaction, causes the remedy to fail.<sup>28</sup>

### A. *The Latent Defect Cases*

The first paradigm is perhaps a red herring since only one reported decision has equated the appearance of latent defects in the goods with failure of essential purpose of a limited remedy, and commentators have argued that the court used an erroneous basis for the decision.<sup>29</sup> In the well-known case, *Wilson Trading Corp. v. David Ferguson, Ltd.*,<sup>30</sup> the New York Court of Appeals was presented with a contract for the sale of yarn containing a disclaimer clause and a clause which refused to allow any claim by the buyer "if made after weaving, knitting, or processing, or more than 10 days after receipt of shipment . . . ." During processing by the buyer the yarn faded and was thereby rendered unfit for the buyer's use. The buyer refused to make payment for the yarn and pleaded the defective quality of the goods as a defense to the seller's suit for the price of the goods. The trial court ruled that the time limitation clause barred the buyer's breach of warranty defense because notice of the defect was not given to the seller within the agreed time. Accordingly, summary judgment was granted plaintiff for the price. On appeal, the New York Court of Appeals reversed the trial court, remanded the case, and held, *inter alia*, that a fact issue existed as to whether the time limitation clause was invalid. The court was of the opinion that if the defects were not discoverable before processing, the clause would have failed of its essential purpose under 2-719(2). The clause would thus be stricken, and all remedial devices provided by article 2 would be available to the buyer. The court apparently reasoned under 2-719(2) that, since the time limitation clause would bar recovery for latent defects not discoverable within ten days or processing, the buyer would have no remedy for such defects and would be deprived of the "substantial

26. REPORT OF THE NEW YORK LAW REVIEW COMMISSION, *supra* note 17, at 584.

27. U.C.C. § 2-719, Comment 1.

28. See *Earl M. Jorgensen Co. v. Mark Constr., Inc.*, 56 Hawaii 466, 540 P.2d 978, 17 UCC Rep. Serv. 1126 (1975). See generally J. WHITE & R. SUMMERS, *supra* note 17, at 380-81.

29. See J. WHITE & R. SUMMERS, *supra* note 17, at 379-81.

30. 23 N.Y.2d 398, 244 N.E.2d 685, 297 N.Y.S.2d 108, 5 UCC Rep. Serv. 1213 (1968).

value of the bargain."<sup>31</sup> Such deprivation would cause the limited remedy to fail of its essential purpose.

It is difficult, however, to track the facts in *Wilson Trading* and the decision of the court with the text of 2-719(2). Arguably, no "exclusive or limited remedy" failed "of its essential purpose" under the facts in the case. It strains semantics to talk of a time limitation as an exclusive or limited remedy. It strains logic and common sense to argue that an essential purpose had failed, that subsequent and unforeseen events had intervened. The clause in question was simply a risk allocator, inserted by the seller for the purpose of limiting its liability by allocating to the buyer risks of latent defects not discoverable within ten days or processing. That purpose had not failed by its subsequently operating to deny the buyer's claim. Indeed that denial was the purpose.<sup>32</sup> Thus, the validity of the clause should have been denied not because of subsequent intervening events under the standards of 2-719(2) but, if at all, because the clause was invalid at its inception either for failure to provide a "minimum adequate remedy" or "fair quantum of remedy" under the standards of 2-719(1)<sup>33</sup> or under the standards of unconscionability<sup>34</sup> or manifest unreasonableness<sup>35</sup> set by the Code for inherently oppressive terms. Justice Fuld, in his concurring opinion, supported this analysis by maintaining that he would have based the decision entirely upon section 1-204's prohibition of "manifestly unreasonable" time limitations.<sup>36</sup> The word seems to have reached the firing line. Two years following *Wilson Trading*, the Third Circuit held a similar time limitation clause under not dissimilar facts to be invalid, not under 2-719(2), but as manifestly unreasonable under 1-204.<sup>37</sup>

The most interesting aspect of the New York Court of Appeals' decision in *Wilson Trading* is that such a distinguished tribunal reached its decision on the basis it did, thereby eschewing several other more direct lines of analysis. And notwithstanding the above critique, the court, as a practical matter, probably gave the subsection an interpretation which will in the future prove to be definitive. While ignoring the unwieldy and perhaps

31. The court quoted Comment 1 to 2-719 which provides that "where an apparently fair and reasonable clause because of circumstances fails in its purpose or operates to deprive either party of the substantial value of the bargain, it must give way to the general remedy provisions of this Article." 23 N.Y.2d at 404, 244 N.E.2d at 688, 297 N.Y.S.2d at 113, 5 UCC Rep. Serv. at 1217.

32. Ironically, the clause failed in its essential purpose by the subsequent event of the court's denying the efficacy of the clause.

33. See text accompanying notes 20-22 *supra*.

34. See U.C.C. § 2-302(1), quoted in note 66 *infra*.

35. U.C.C. § 1-204(1) provides: "Whenever this Act requires any action to be taken within a reasonable time, any time which is not manifestly unreasonable may be fixed by agreement." See also U.C.C. § 2-607(3)(a).

36. 23 N.Y.2d at 405, 244 N.E.2d at 689, 297 N.Y.S.2d at 114, 5 UCC Rep. Serv. at 1219 (Fuld, J., concurring).

37. *Neville Chem. Co. v. Union Carbide Corp.*, 422 F.2d 1205, 7 UCC Rep. Serv. 81 (3d Cir.), *cert. denied*, 400 U.S. 826 (1970). Pre-Code cases used a similar approach. See *Kansas City Wholesale Grocery Co. v. Weber Packing Corp.*, 93 Utah 414, 73 P.2d 1272 (1937). See also *Cyclops Corp. v. Home Ins. Co.*, 389 F. Supp. 476, 481, 16 UCC Rep. Serv. 415, 422 (W.D. Pa. 1975).



literally meaningless language of 2-719(2),<sup>38</sup> the court directed its attention to the accompanying Official Comment: "[U]nder subsection (2), where an apparently fair and reasonable clause because of circumstances fails in its purpose or operates to deprive either party of the substantial value of the bargain, it must give way to the general remedy provisions of this Article."<sup>39</sup> Thus, under 2-719(2), the test for continued efficacy of a remedy limitation clause is substantial bargain deprivation, in addition to, or instead of, failure of essential purpose. When a remedy limitation operates to deprive a party of the substantial value of his bargain it has failed of its essential purpose.<sup>40</sup> Under the facts in *Wilson Trading* the court reasoned that the intervening appearance of latent defects in the yarn, defects that could not be discovered until after processing and, thus, after claims could be made by the buyer under the terms of the contract, operated to deprive the buyer of the substantial value of his bargain. Accordingly, the clause failed of its essential purpose under 2-719.

In reaching its decision, the court presumably found that the clause was valid at its inception under 2-719(1), but that the unanticipated subsequent circumstance of latent defect rendered the clause inoperative. In short, the parties had not intended by the clause to allocate to the buyer risks of latent defects. Otherwise the court would have, as some have suggested it should have,<sup>41</sup> tested the validity of the clause under the Code provisions relating to unconscionability, manifest unreasonableness, or failure to provide the buyer with a fair quantum of remedy.<sup>42</sup> Thus, *Wilson Trading* is consistent with a long line of judicial decisions in this country which illustrate a marked reluctance to enforce remedy limitations or warranty disclaimers in the teeth of latent defects.<sup>43</sup> If sellers wish to allocate risks for latent defects to buyers

38. As Professor Nordstrom has pointed out, "Remedies do not have 'purposes'—let alone an essential purpose. People have purposes . . . ." R. NORDSTROM, HANDBOOK OF THE LAW OF SALES 276 (1970). According to Professors White and Summers, "[t]here are probably relatively few situations where a remedy can fail of its essential purpose." J. WHITE & R. SUMMERS, *supra* note 16, at 382.

39. U.C.C. § 2-719, Comment 1 (emphasis added).

40. In applying this standard, however, care must be taken to ascertain exactly what the party has bargained for. If the buyer of goods has agreed to assume the risk of latent defects in the goods then the subsequent appearance of such defects gives him his bargain, no more and no less. Professor Ellinghaus has drawn an interesting parallel between Code standards such as substantial value deprivation and the British concept of "fundamental breach" or "fundamental terms." Ellinghaus, *supra* note 17, at 797-800. The doctrine of fundamental breach has been defined as follows: "Every contract contains a 'core' or fundamental obligation which must be performed. If one party fails to perform this fundamental obligation, he will be guilty of a breach of the contract whether or not any exempting clause has been inserted which purports to protect him." Guest, *Fundamental Breach of Contract*, 77 L.Q. REV. 98, 99 (1961).

41. J. WHITE & R. SUMMERS, *supra* note 17, at 381.

42. See the discussion in the text accompanying notes 32-35 *supra*. However, it was possible for the court in *Wilson Trading* to conclude that the seller retained the risk of responsibility for latent defects notwithstanding the time limitation clause because the seller had expressly warranted the yarn to be merchantable.

43. See, e.g., *County Asphalt, Inc. v. Lewis Welding & Eng'r Corp.*, 323 F. Supp. 1300, 1308, 8 UCC Rep. Serv. 445, 447 (S.D.N.Y. 1970), *aff'd on other grounds*, 444 F.2d 372, 9 UCC Rep. Serv. 206 (2d Cir.), *cert. denied*, 404 U.S. 939 (1971), in which the court observes that contracts between commercial entities are virtually never held to be unconscionable absent latent defects. See also *Neville Chem. Co. v. Union Carbide Corp.*, 294 F. Supp. 649, 5 UCC Rep. Serv. 1219 (W.D. Pa. 1968), *rev'd in part*, 422 F.2d 1205 (3d Cir. 1970); *Dessert Seed Co. v. Drew Farmers Supply, Inc.*, 248 Ark. 858, 454 S.W.2d 307, 7 UCC Rep. Serv. 995 (1970); *Granite Worsted Mills, Inc. v. Aaronson Cowen, Ltd.*, 29 App. Div. 2d 303, 287 N.Y.S.2d 765, 5 UCC Rep. Serv. 98 (1968); *Jessel v. Lockwood Textile Corp.*, 276 App. Div. 378, 95 N.Y.S.2d

they must draft their clauses in certain terms and be ready to stand the test of fairness and lack of overreaching in the bargaining process.<sup>44</sup>

At the price of wailing in the winds of realism, it is irresistible to point out that there is nothing in the text of 2-719(2) which supports the "substantial value of the bargain" criterion for judging the efficacy of remedy limitations.<sup>45</sup> It is great classroom fodder, but poor real-world ammunition, that the Official Comments to the Code have not been enacted into law in any jurisdiction, that they often go beyond and even contradict the text of the provision they purport to explain, and that as a matter of drafting history they often do not coincide in time or substance with the text to which they are appended. Like ducks to water, students of the Code as well as the courts have taken to the Comments. Indeed, the temptation is unavoidable when the choice is between meaty and meaningful talk like "substantial value of the bargain" on the one hand and confusing and quivery gelatine like "failure of essential purpose of an exclusive remedy" on the other. And the case law subsequent to *Wilson Trading* consistently reinforces the proposition that substantial value deprivation has largely supplanted failure of essential purpose as the true standard for judging the effectiveness of remedy limitations under 2-719(2).<sup>46</sup>

### B. The "Standard" Cases

The second general fact paradigm under which 2-719(2) cases can be classified is represented by situations in which an exclusive remedy has been provided, commonly repair or replacement of defective parts or refund of the purchase price, and by his action or inaction the party responsible for providing the remedy causes the remedy to fail. The law reporters abound with cases falling under this paradigm.<sup>47</sup> These I call the "standard" 2-719(2)

77 (1950); *Kansas City Wholesale Grocery Co. v. Weber Packing Corp.*, 93 Utah 414, 73 P.2d 1272 (1937). But see *Major v. Kalo Laboratories*, 407 F. Supp. 20, 18 UCC Rep. Serv. 592 (M.D. Ala. 1975); *Cyclops Corp. v. Home Ins. Co.*, 389 F. Supp. 476, 16 UCC Rep. Serv. 415 (W.D. Pa. 1975); *Corneli Seed Co. v. Ferguson*, 64 So.2d 162 (Fla. 1953).

44. Of course, these standards can be met, even with respect to latent defects. See *Cyclops Corp. v. Home Ins. Co.*, 389 F. Supp. 476, 16 UCC Rep. Serv. 415 (W.D. Pa. 1975).

45. Prior drafts of the Code, however, did meld the "substantial value of the bargain" criterion with failure of essential purpose. The May 1949 draft of art. 2 provided:

(2) Where circumstances cause an exclusive or limited remedy to fail of its essential purpose, as when it deprives the buyer of the *substantial value of the contract* or of the use or disposition for which the seller at the time of contracting had reason to know the goods were intended, remedy may be had as provided in this Act.

ALI NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS, UNIFORM COMMERCIAL CODE § 2-721 (May 1949 Draft) (emphasis added). See also §§ 122(2) and 123 of the 1944 draft, ALI JOINT EDITORIAL COMMITTEE, NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS, UNIFORM REVISED SALES ACT §§ 122(2), 123 (Proposed Final Draft No. 1, 1944) (Sales Chapter of Proposed Commercial Code).

46. See, e.g., *Majors v. Kalo Laboratories*, 407 F. Supp. 20, 18 UCC Rep. Serv. 592 (M.D. Ala. 1975); *Earl M. Jorgensen Co. v. Mark Constr. Co.*, 56 Hawaii 466, 540 P.2d 978, 17 UCC Rep. Serv. 1126 (1975); *Reynolds v. Preferred Mut. Co.*, 11 UCC Rep. Serv. 701 (Mass. App. Div. 1972); *Ehlers v. Chrysler Motor Corp.*, 226 N.W.2d 157, 16 UCC Rep. Serv. 737 (S.D. 1975).

47. See *Riley v. Ford Motor Co.*, 442 F.2d 670, 8 UCC Rep. Serv. 1175 (5th Cir. 1971); *Koehring Co. v. A.P.I., Inc.*, 369 F. Supp. 882, 14 UCC Rep. Serv. 368 (E.D. Mich. 1974); *Jones & McKnight Corp. v. Birdsboro Corp.*, 320 F. Supp. 39, 8 UCC Rep. Serv. 307 (N.D. Ill. 1970); *Morris v. Chevrolet Motor Div. of Gen. Motors Corp.*, 39 Cal. App. 3d 917, 114 Cal. Rptr. 747, 14 UCC Rep. Serv. 1294 (1974); *Ehlers v. Chrysler Motor Corp.*, 226 N.W.2d 157, 16 UCC Rep. Serv. 736 (S.D. 1975); *Moore v. Howard Pontiac-American, Inc.*, 492 S.W.2d 227, 12

cases, because they have become plentiful, they meld well with the text and apparent purpose of subsection 2-719(2), and they involve an exclusive remedy which was minimally adequate and thus valid at the inception of the contract. Unlike in the latent defect cases, in the standard 2-719(2) cases the analysis by the courts closely tracks the textual language of 2-719(2)—an exclusive remedy has obviously failed. Moreover, the remedy failed of its essential purpose as well, since to be valid its purpose must have been to provide, in addition to a limitation of liability for the seller, a minimum adequate remedy for the buyer.

A straightforward example of this basic factual setting is presented by *Moore v. Howard Pontiac-American, Inc.*<sup>48</sup> *Moore* is a typical "lemon" automobile case. The automobile had defects in the doors, windows, paint, engine, and brakes, as well as air and water leaks. The buyer purchased the automobile on May 29, 1971, under a contract containing a standard new car warranty limiting liability of the manufacturer to repair or replacement of defective parts for a period of twelve months or twelve thousand miles, whichever first occurred. There was testimony that the defects were discovered by the buyer shortly after the sale and that soon thereafter the buyer requested the seller to take the car back and give him another. The seller refused, and the buyer filed suit "for rescission"<sup>49</sup> on August 3, 1971, at which time the buyer stored the automobile. The buyer, however, began using the automobile again approximately two months after suit. Both before and after the filing of the suit the seller undertook to repair the defects, but the undertakings were ineffective, or where effective, created new problems or caused new damage. Under these facts the court held that in terms of 2-719(2) circumstances had caused the limited remedy of repair or replacement to fail of its essential purpose<sup>50</sup> and said: "In this case, though given the opportunity to comply with its warranty, appellant either could not or would not make the necessary repairs or parts replacement to give appellees that which they purchased—an automobile substantially free of material defects—thus freeing appellants to seek other relief."<sup>51</sup> The relief allowed by the court was revocation of acceptance under section 2-608.<sup>52</sup>

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UCC Rep. Serv. 676 (Tenn. Ct. App. 1972). For a pre-Code treatment of the paradigm, see *Steele v. J.I. Case Co.*, 197 Kan. 554, 419 P.2d 902 (1966).

In a similar vein the Magnuson-Moss Warranty Act provides that to qualify as a "full" warranty the warrantor must allow the consumer to elect a refund of the purchase price or a replacement of the product without charge if a defect cannot be corrected after a reasonable number of attempts. 15 U.S.C. § 2304(a)(4) (Supp. V 1975). See note 16 *supra*.

48. 492 S.W.2d 227, 12 UCC Rep. Serv. 676 (Tenn. Ct. App. 1972).

49. The case is yet another example of a court speaking in terms of rescission, a term not used by the Code, when the referent is actually revocation of acceptance under § 2-608 of the Code. *Id.* at 229, 12 UCC Rep. Serv. at 679.

50. Although the court did not attempt to define the essential purpose which had failed, the gist of the court's reasoning was that the buyer should have recourse to other remedies because he had not been provided substantially what was bargained for, an automobile free from defects.

51. 492 S.W.2d at 229, 12 UCC Rep. Serv. at 679.

52. The court did not discuss the apparent absolute bar to revocation under 2-608(2) which requires that revocation must occur "before any substantial change in condition of the goods which is not caused by their own defects." See *Eckstein v. Cummins*, 41 Ohio App. 2d 1, 321 N.E.2d 897, 16 UCC Rep. Serv. 373 (1974), for an application of the 2-608(2) bar on similar facts. Interestingly enough, however, the court in *Moore* allowed the seller "an offset" for the buyer's use of the automobile during the time it was in his possession.

A similar and better known case on point is the oft-cited decision of the Fifth Circuit in *Riley v. Ford Motor Co.*<sup>53</sup> The facts fit the standard mold: a purchase of defective goods, again an automobile, the standard repair or replacement warranty, and the inability or unwillingness of the seller to correct the defects after being given a reasonable opportunity to do so.<sup>54</sup> The court held that the remedy limitation failed under 2-719(2). In reaching its decision, however, the court went beyond the failure of essential purpose language in the text of 2-719(2) and into the Official Comment to 2-719, emphasizing that to enforce the remedy limitation under these facts would deprive the buyer of the substantial value of his bargain.<sup>55</sup>

Thus, the standard, 2-719(2) cases, such as *Moore* and *Riley*, are similar to the latent defect cases in a couple of interesting respects. First, the courts rarely attempt to illuminate the essential purpose that has failed.<sup>56</sup> Secondly, even though the courts are dealing with facts that closely track the text of 2-719(2), they are irresistibly drawn to the standard of the Official Comment that the party subject to the remedy limitation receive "the substantial value of the bargain." In *Riley* the court quoted from the Official Comment, and in *Moore* the court was concerned that the buyer get what was intended to be purchased, "an automobile substantially free from defects."<sup>57</sup> Thus, as in the latent defect cases, the primary standard for the efficacy of an exclusive remedy limitation remains substantial value deprivation. Again, the reason is apparent. It is much easier to talk in terms of and to understand the unsuccessful performance of a limited remedy depriving a party of the value of the bargain than it is to speak meaningfully of such unsuccessful performance as representing a failure of essential purpose. Arguably, the only purpose of an exclusive remedy is to limit recourse, and that purpose is logically independent of the success or failure of the prescribed remedy. Speaking of the failure of essential purpose of a remedy limitation is semantically awkward; speaking of the failure of the remedy to provide one with the substantial value of his bargain is comparatively much easier.

The only reported decision I have found which attempts to delineate precisely the purpose behind an exclusive remedy limitation is *Beal v. General Motors Corp.*<sup>58</sup> *Beal* was a standard 2-719(2) case involving the sale of a truck under a contract limiting recourse under the warranty to repair or replacement, and the inability or unwillingness of the seller to repair or replace defective parts. In reaching its decision, the court said:

The purpose of an exclusive remedy of replacement or repair of defective parts, whose presence constitute a breach of an express

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53. 442 F.2d 670, 8 UCC Rep. Serv. 1175 (5th Cir. 1971).

54. In *Riley* the jury found that Ford had had a reasonable opportunity to repair under the warranty after but one attempt. Judge Aldisert noted for the court on appeal that rather than complying with Ford's technical service representative's recommendation that another go be had at repair, "the owner believed he had a better idea . . . he brought this action against Ford . . . ." *Id.* at 672, 8 UCC Rep. Serv. at 1177.

55. *Id.* at 674, 8 UCC Rep. Serv. at 1178-79. Unlike *Moore*, *Riley* allowed money damages under 2-714 as the remedy rather than revocation of acceptance.

56. See also *Reynolds v. Preferred Mut. Ins. Co.*, 11 UCC Rep. Serv. 701 (Mass. App. Div. 1972).

57. See note 51 *supra*.

58. 354 F. Supp. 423, 12 UCC Rep. Serv. 105 (D. Del. 1973).

warranty, is to give the seller an opportunity to make the goods conforming while limiting the risks to which he is subject by excluding direct and consequential damages that might otherwise arise. From the point of view of the buyer the purpose of the exclusive remedy is to give him goods that conform to the contract within a reasonable time after a defective part is discovered. When the warrantor fails to correct the defect as promised within a reasonable time he is liable for a breach of that warranty . . . . The limited, exclusive remedy fails of its purpose and is thus avoided under § 2-719(2), whenever the warrantor fails to correct the defect within a reasonable period.<sup>59</sup>

The following language is, however, more typical even of a standard 2-719(2) case. "By delaying for an unreasonable length of time the repair of respondent's vehicle, appellant deprived him of the 'substantial value of the bargain.' Stated otherwise, the warranty was breached causing the available remedy 'to fail of its essential purpose.' Such failure brings into play all otherwise available remedial devices . . . ." <sup>60</sup>

In sum, the reported decisions under 2-719(2) are represented by two fact paradigms, the latent defect situations and the situations in which the party responsible for providing an exclusive remedy causes that remedy to fail. The reported decisions further make clear that the operative standard for the continued efficacy of an exclusive remedy limitation under 2-719(2) is whether or not giving effect to the limitation will deprive the party subject to it of the substantial value of his bargain. Substantial value deprivation is a sufficiently subjective standard to allow the courts a quantum of discretion in determining the continued validity of remedy limitations.<sup>61</sup> Finally, 2-719(2), when properly construed, is applicable only with respect to situations involving an exclusive remedy limitation which was valid at the outset of the contract but is rendered unenforceable because of subsequent intervening circumstances. In less than a decade, then, the courts have taken the amorphous language of one of the most important and widely litigated sections of the Code and given it a concise and straightforward construction.<sup>62</sup>

Indeed, the only real aberrations from the foregoing analysis are those cases in which the courts have failed to limit the application of 2-719(2) to exclusive remedy limitations which were valid at the inception of the con-

59. *Id.* at 426, 12 UCC Rep. Serv. at 109.

60. *Ehlers v. Chrysler Motor Corp.*, 226 N.W.2d 157, 161, 16 UCC Rep. Serv. 737, 740 (S.D. 1975). For an interesting case involving both factual paradigms, latent defects as well as the inability of the seller to repair them, see *Earl M. Jorgensen Co. v. Mark Constr. Co.*, 56 Hawaii 466, 540 P.2d 978, 17 UCC Rep. Serv. 1126 (1975).

61. For cases holding either that the exclusive remedy had not failed or that the party subject to the limitation had not been deprived of the substantial value of the bargain, see *Fredonia Broadcasting Corp. v. RCA Corp.*, 481 F.2d 781, 12 UCC Rep. Serv. 1088 (5th Cir. 1973); *V-M. Corp. v. Bernard Distrib. Co.*, 447 F.2d 864, 9 UCC Rep. Serv. 670 (7th Cir. 1971); *Cyclops Corp. v. Home Ins. Co.*, 389 F. Supp. 476, 16 UCC Rep. Serv. 415 (W.D. Pa. 1975); *Potomac Elec. Power Co. v. Westinghouse Elec. Corp.*, 385 F. Supp. 572, 16 UCC Rep. Serv. 360 (D.C. Cir. 1974); *Farmers Union Grain Terminal Ass'n v. Nelson*, 223 N.W.2d 494, 17 UCC Rep. Serv. 139 (N.D. 1974); *Lankford v. Rogers Ford Sales*, 478 S.W.2d 248, 10 UCC Rep. Serv. 777 (Tex. Civ. App.—El Paso 1972, writ ref'd n.r.e.).

62. This kind of assertion overstates any situation. For example, there is a line of cases apparently holding that regardless of the seller's inability to repair under the terms of a repair or replacement warranty or exclusive remedy, there is no failure of essential purpose if the seller was in good faith and used best efforts. For a discussion of these cases see the text accompanying notes 104-08 and note 108 *infra*.

tract. For example, as noted earlier the *Wilson Trading* decision has been criticized because the case would have been more properly analyzed as one involving a clause invalid at the outset of the contract.<sup>63</sup> The problem with the decisions which are guilty of this kind of oversight is that they inevitably complicate and confuse their analysis by applying unrelated Code provisions which involve incompatible standards. Thus in *Eckstein v. Cummins*,<sup>64</sup> another typical defective automobile case indistinguishable for present purposes from the *Moore* and *Riley* cases,<sup>65</sup> the incompatible ingredient in the mix was unconscionability under section 2-302 of the Code.<sup>66</sup> The court concluded that:

[T]o place the purchaser of a defective vehicle incapable of repair in the anomalous position of having no actionable claim for relief pursuant to the strict language of the express warranty and disclaimer therein, because the precise nature of the defect cannot be determined and the plaintiff cannot identify any defective part, the replacement of which could remedy the defect, would be to defeat the very purpose of the warranty which had been given to the purchaser. Such a result would substantially deprive the buyer of the benefit of his bargain and is unconscionable. Although the warranty and disclaimer, which is strictly limited to parts, is not unconscionable on its face, it cannot be applied to the facts in a conscionable manner. Otherwise, there would be noncompliance with [2-302 and 2-719(2)].<sup>67</sup>

Despite the wording used by the court, however, it is doubtful that unconscionability under 2-302 would operate as an independent bar to the efficacy of the remedy limitation apart from 2-719(2); section 2-302 speaks to a provision unconscionable at the time of making the contract whereas 2-719(2) and the facts with which the court was dealing speak to an agreement valid at its inception which is rendered questionable by intervening circumstances.<sup>68</sup> The courts, of course, have consistently upheld exclusive remedy limitations of repair or replacement of defective parts in contracts of sale of new automobiles. Extraordinary indeed would be the facts of the case in which a court held such a limitation in such a contract invalid from the outset.

Even more troublesome are cases which confuse warranty disclaimers with remedy limitations. Actually this error is rather hard to make because the applicable Code provision is explicit. After establishing the methods by

63. See text accompanying notes 29-36 *supra*.

64. 41 Ohio App. 2d 10, 321 N.E.2d 897, 16 UCC Rep. Serv. 373 (1974).

65. Except for perhaps the extraordinarily valiant attempts by the seller to cure the defects of which the buyer complained. *Id.* at 11, 321 N.E.2d at 899, 16 UCC Rep. Serv. at 375.

66. U.C.C. § 2-302(1) provides:

(1) If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.

67. 41 Ohio App. 2d at 15, 321 N.E.2d at 904, 16 UCC Rep. Serv. at 379. *But see* Eddy, *supra* note 19, at 31-32. Professor Eddy takes the position that "contract clauses do not change their scope of application, having one application at the time of formation and another at the time of decision." *Id.* at 31. See also Ellinghaus, *supra*, note 17, at 802-03.

68. But courts as well as commentators continue to make this oversight. See *Majors v. Kalo Laboratories*, 407 F. Supp. 20, 18 UCC Rep. Serv. 592 (M.D. Ala. 1975); Fahlgren, *supra* note 19, at 443.

which warranties can be disclaimed, section 2-316 of the Code in subsection (4) provides: "Remedies for breach of warranty can be limited in accordance with the provisions of this Article on liquidation or limitation of damages and on contractual modification of remedy (Sections 2-718 and 2-719)."<sup>69</sup> Thus, sellers who do not wish to disclaim absolutely their warranties under 2-316 can buffer their responsibility for breach of those warranties by modifying or limiting the remedies of buyers against them under the standards of sections 2-718 and 2-719.

Nevertheless, decisions overlooking this straightforward proposition continue to be rendered. One such case, *National Cash Register Co. v. Adell Industries, Inc.*,<sup>70</sup> involved the sale of a bookkeeping machine under a contract limiting the buyer's remedies to repair or replacement of defective parts. The trial court found that the seller had made and breached an implied warranty of fitness for a particular purpose. The machine developed defects which the seller was unable to repair after having been given a reasonable opportunity. On appeal from a decision of the trial court striking the seller's remedy limitation, the court held:

The Code does authorize parties to limit a buyer's remedies to repair and replacement of nonconforming goods or parts, but the same section provides that: 'Where circumstances cause an exclusive or limited remedy to fail of its essential purpose, remedy may be had as provided in this act . . . .'

In our opinion the contractual limitation did not apply to the implied warranty, but even if it did the defendant's remedy of revocation is saved, because nothing short of an effective right of revocation would ordinarily satisfy the essential purpose of an implied warranty of fitness for a particular purpose.<sup>71</sup>

Nowhere does the Code speak of the essential purpose of implied warranties. Nor does it contemplate exclusive remedies applying to the breach of some warranties but not others, absent specific language in the contract to that effect. The court should have simply reasoned that to give effect to the exclusive remedy limitation under circumstances in which the seller had caused that remedy to fail by its inability to cure the defects would deprive the buyer of the substantial value of the bargain.<sup>72</sup>

## II. CLAUSES EXCLUDING LIABILITY FOR CONSEQUENTIAL DAMAGES

Give or take an occasional maverick decision, however, the cases relying on subsection 2-719(2) of the Code are reasonably clear. The question then becomes what damages are recoverable, and, in particular, whether consequential damages are recoverable despite an independent clause in the contract excluding liability for consequential damages. Under one suggested reading of the Code<sup>73</sup> the answer is affirmative because 2-719(2) provides

69. U.C.C. § 2-316(4).

70. 57 Mich. App. 413, 225 N.W.2d 785, 16 UCC Rep. Serv. 656 (1975).

71. 225 N.W.2d at 787, 16 UCC Rep. Serv. at 659.

72. But, again, courts continue to confuse warranty disclaimers on the one hand with exclusive remedy limitations on the other. See, e.g., *Dessert Seed Co. v. Drew Farmers Supply, Inc.*, 248 Ark. 858, 454 S.W.2d 307, 309, 7 UCC Rep. Serv. 995, 999 (1970).

73. See J. WHITE & R. SUMMERS, *supra* note 17, at 382.

that when an exclusive remedy fails of its essential purpose "remedy may be had as provided in this Act,"<sup>74</sup> and the accompanying Comment provides that upon such failure the limitation "must give way to the general remedy provisions of this Article."<sup>75</sup> This reading, however, is not strictly accurate. Consequential damage exclusions are governed by a separate subsection and a separate Comment. Subsection 2-719(3) states: "Consequential damages may be limited or excluded unless the limitation or exclusion is unconscionable. Limitation of consequential damages for injury to the person in the case of consumer goods is prima facie unconscionable but limitation of damages where the loss is commercial is not."<sup>76</sup> And Comment 3 states that: "Subsection (3) recognizes the validity of clauses limiting or excluding consequential damages but makes it clear that they may not operate in an unconscionable manner. Actually such terms are merely an allocation of unknown or undeterminable risks."<sup>77</sup> Thus, the standard for upholding a consequential damage exclusion is conscionability, wholly apart from whether or not an exclusive remedy has failed of its essential purpose.<sup>78</sup> Assuming conscionability at the inception of the contract, the buyer<sup>79</sup> has been allocated the risk of consequential damages and our question becomes whether it would be unconscionable for the buyer to retain that risk upon failure of the essential purpose of an exclusive remedy. But a literal reading of the Code does *not* mandate that in every case of failure of the essential purpose of an exclusive remedy consequential damages are recoverable in the teeth of a separate provision of the contract which excludes liability for such damages.<sup>80</sup>

This was the position taken in *County Asphalt, Inc. v. Lewis Welding & Engineering Corp.*<sup>81</sup> The court said:

Plaintiff would have U.C.C. § 2-719 read in such a fashion as to result in all limitations whatsoever being stricken in any event in which an exclusive remedy should fail of its essential purpose. A better reading is that the exclusive remedy clause should be ignored; other clauses limiting remedies in less drastic manners and on different theories would be left to stand or fall independently of the stricken clause. Since

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74. U.C.C. § 2-719(2).

75. U.C.C. § 2-719, Comment 1.

76. U.C.C. § 2-719(3).

77. U.C.C. § 2-719, Comment 3.

78. In the words of one court referring to an exclusive remedy limitation and consequential damage disclaimer, "This attempted contractual modification or limitation of remedy is ineffective if it fails of its essential purpose, or is unconscionable; except as to consequential damages it would be ineffective only if unconscionable." *Kohlenberger, Inc. v. Tyson's Foods, Inc.*, 256 Ark. 584, 510 S.W.2d 555, 14 UCC Rep. Serv. 1281 (1974).

79. Although U.C.C. 2-715(2) contemplates a buyer's recovery of consequential damages, nowhere in the Code is there provision for recovery of consequential damages by a seller. It would be difficult, although not impossible, to hypothesize a realistic situation in which a seller would suffer consequential damages upon a breach by a buyer of a contract for the sale of goods.

80. It is also somewhat significant that the subsection dealing with consequential damage exclusions, 2-719(3), follows the subsection providing for the failure of an exclusive remedy limitation, 2-719(2). If the draftsmen had intended that consequential damage exclusions were to be subjected to the standards for failure of exclusive remedy limitations, the position of the respective subsections within 2-719 would be reversed or at least the subsections would refer to one another.

81. 323 F. Supp. 1300, 8 UCC Rep. Serv. 445 (S.D.N.Y. 1970), *aff'd*, 444 F.2d 372, 9 UCC Rep. Serv. 206 (2d Cir.), *cert. denied*, 404 U.S. 939 (1971).



the clause excluding consequential damages has been held not unconscionable, and is not otherwise offensive, it will be applied.<sup>82</sup>

Although the court does not explain what it means by classifying clauses excluding consequential damages as examples of "other clauses limiting remedies in less drastic manners and on different theories," the proposition is sound. As a general matter, consequential damages exclusions are hands down the most significant limitation of liability in a contract for the sale of goods. Potential liability for consequential damages in commercial contexts, usually in the form of the buyer's lost profits from the use or resale of the goods in its business, is enormous in comparison to the contract price of the goods. On the other hand, the general or direct damages that a buyer may suffer upon a seller's breach are finite and can be gauged at a maximum amount either in terms of the contract price or market price of the goods to be sold. Potential consequential losses are a much different proposition. They can exceed, and most likely will exceed, the value of the goods by an unknown quantum, depending not so much on the actions and machinations of the seller as on the individual operating structure of the buyer and on the buyer's contracts and relationships with third parties.

It is for these reasons that since our system began to formulate a definite framework of contract damage law,<sup>83</sup> parties who breach contracts have been held not liable for consequential damages thereby engendered unless such damages are foreseeable. The Uniform Commercial Code certainly carries forward this foreseeability requirement, albeit in one of its milder forms.<sup>84</sup> The Code rejects the so-called "tacit agreement" test for foreseeability<sup>85</sup> which requires not only that the breaching party must have been able to foresee the likelihood of such damages at the time of contracting, but also that the circumstances surrounding the contracting must have been such that the breaching party could be said to have at least tacitly agreed to be liable for the consequential damages.<sup>86</sup> The Official Comments to section 2-715 states:

[T]he seller is liable for consequential damages in all cases where he had reason to know of the buyer's general or particular requirements at the time of contracting. It is not necessary that there be a conscious acceptance of an insurer's liability on the seller's part . . . .

Any seller who does not wish to take the risk of consequential

82. 323 F. Supp. at 1300, 8 UCC Rep. Serv. at 448-49.

83. Circa 1854 with *Hadley v. Baxendale*, 9 Exch. 341, 156 Eng. Rep. 145 (1854). See G. GILMORE, *THE DEATH OF CONTRACT* 49 (1974).

84. See U.C.C. § 2-715(2) which provides:

Consequential damages resulting from the seller's breach include

(a) any loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know and which could not reasonably be prevented by cover or otherwise; and  
(b) injury to person or property proximately resulting from any breach of warranty. (Emphasis added.)

85. U.C.C. § 2-715, Comment 2 states clearly that "[t]he 'tacit agreement' test for the recovery of consequential damages is rejected . . . . [T]he older rule at common law which made the seller liable for all consequential damages of which he had 'reason to know' in advance is followed . . . ."

86. For a general discussion of the tacit agreement doctrine see D. DOBBS, *HANDBOOK ON THE LAW OF REMEDIES* 805 (1973); C. MCCORMICK, *HANDBOOK OF THE LAW OF DAMAGES* 575-81 (1935); J. MURRAY, *MURRAY ON CONTRACTS* 453-56 (1974).

damages has available the section on consequential limitation of remedy.<sup>87</sup>

The Code principles with respect to clauses excluding consequential damages, then, seem reasonably clear. Generally speaking, the Code, by markedly relaxing the foreseeability bar to consequential damage recovery, takes an expansive attitude toward sellers' responsibility for the consequential losses of their buyers. Cutting in the opposite direction, however, are the Code provisions granting sellers broad based permission to reallocate this responsibility to buyers via private contract. A literal reading of the applicable Code provision and commentary gives such reallocation, at least with respect to commercial losses, *prima facie* validity and makes unconscionability rather than failure of essential purpose the base line standard for the efficacy of clauses excluding seller liability for consequential damages.

It does not automatically follow, however, that upon failure of the essential purpose of an exclusive remedy the enforcement of a clause excluding liability for consequential damages would be unconscionable. Such clauses are merely "an allocation of unknown or undeterminable risks"<sup>88</sup> and the occurrence of such risks might not necessarily deprive the buyer of the substantial value of his bargain; they might instead be merely an accurate reflection of that bargain. The most obvious case of this sort would be one in which the failure of the exclusive remedy did not cause the consequential damages beyond those which the buyer had been allocated by the contract. Assume the sale of a standard curdleguncher under the usual repair or replacement warranty, limiting the buyer's remedy exclusively to the repair or replacement of defective parts for a limited period of time, disclaiming all other express or implied warranties, and excluding liability for consequential damages. Assume further that because of a defect the machine improperly gunches a large order of curdles, causing the buyer of the curdleguncher consequential damages in the form of lost profits on curdle sales. The seller of the curdleguncher is either unable or unwilling to repair the defect in the machine. Under such circumstances most courts would hold that the exclusive remedy had failed of its essential purpose, thus entitling the buyer to money damages for breach of warranty.<sup>89</sup> Nevertheless, the buyer should

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87. U.C.C. § 2-715, Comment 3.

88. See text accompanying note 77 *supra*.

89. The applicable damage formula is reflected in § 2-714 which provides:

(1) Where the buyer has accepted goods and given notification (subsection (3) of Section 2-607) he may recover as damages for any non-conformity of tender the loss resulting in the ordinary course of events from the seller's breach as determined in any manner which is reasonable.

(2) The measure of damages for breach of warranty is the difference at the time and place of acceptance between the value of the goods accepted and the value they would have had if they had been as warranted, unless special circumstances show proximate damages of a different amount.

(3) In a proper case any incidental and consequential damages under the next section may also be recovered.

If there has not been "any substantial change in condition of the goods which is not caused by their own defects" the buyer may revoke acceptance of the goods instead of recovering money damages for breach of warranty. U.C.C. § 2-608 provides:

(1) The buyer may revoke his acceptance of a lot or commercial unit whose non-conformity substantially impairs its value to him if he has accepted it

not be allowed consequential damages for lost profits on the order of defective curdles absent independent proof of unconscionability. Such damages were excluded by an independent clause of the contract and the buyer's loss was therefore in no way caused by the seller's inability or refusal to honor the repair or replacement warranty. Nothing has occurred either in the subsequent circumstances or conduct of the parties which should affect the original allocation of the risks by the parties. Further, lost profits on future orders of curdles should not be recoverable by the buyer if he could have avoided them by purchasing a new machine or by having a third party repair the defective one.<sup>90</sup> Like the lost profits on the order of defective curdles, these avoidable losses were arguably not caused by the seller's breach of warranty.

But what of those consequential losses clearly caused by the seller's failure or refusal to repair: that is, profits lost on orders for curdles subsequent to the time when the seller should have timely repaired the machine but prior to the time in which the buyer could have avoided the loss by repairing the machine or finding a substitute? Clearly the seller should be responsible for these consequential damages caused by his breach. In the vernacular of the Code it would be unconscionable to enforce a clause excluding such damages in light of the seller's conduct. At the time of contracting, when the risk of consequential damages was allocated to the buyer, the seller promised to repair or replace defective parts in the machine. Further, he would be required to fulfill this promise in a timely and reasonable manner,<sup>91</sup> thereby mitigating the potential consequential losses of the buyer. Thus, at the time of contracting the buyer had not agreed to assume liability for open-ended consequential losses. He had agreed to assume only those losses occurring during a reasonable period for the seller to correct the defects and to give the buyer the substantial value of the bargain: a machine substantially free from defects undercut by circumscribed consequential damages liability.

The conclusion proceeds from a straightforward analysis. If there is a direct causal relationship between the failure of the exclusive remedy and the occurrence of consequential damages which the buyer had not agreed to assume, then a basic presumption of the parties in allocating the risks of such damages to the buyer has also failed. In such a situation it would be unconscionable to read a clause in the contract so as to exclude the seller's

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(a) on the reasonable assumption that its non-conformity would be cured and it has not been seasonably cured; or

(b) without discovery of such non-conformity if his acceptance was reasonably induced either by the difficulty of discovery before acceptance or by the seller's assurances.

(2) Revocation of acceptance must occur within a reasonable time after the buyer discovers or should have discovered the ground for it and before any substantial change in condition of the goods which is not caused by their own defects. It is not effective until the buyer notifies the seller of it.

(3) A buyer who so revokes has the same rights and duties with regard to the goods involved as if he had rejected them.

90. See U.C.C. § 2-715(2)(a) quoted at note 84 *supra*.

91. See U.C.C. § 2-309(1), which provides: "The time for shipment or delivery or any other action under a contract if not provided in this Article or agreed upon shall be a reasonable time."

liability for such damages. On the other hand, absent such a causal relationship there is no reason to disturb the parties' allocation of unknown risks; leaving consequential losses on the buyer merely enforces the bargain of the parties.<sup>92</sup>

The only case I can think of which would be variant from this analysis is where the parties expressly or implicitly agree to the contrary. For example, if the goods are highly experimental in nature the parties may be said to be aware that defects are quite likely to occur. Further, these defects may be incurable even if the seller exercises his best efforts. Despite this knowledge, or indeed because of it, the buyer agrees to a clause excluding liability of the seller for consequential damages. If defects occur which the seller is unable to cure, such a clause should clearly be effective to bar the seller's liability even though the seller's inability to repair has caused the buyer's consequential losses. Arguably, the seller has not breached his warranty, having implicitly promised on these unique facts only to use his best efforts to correct defects. In any event, nothing has occurred subsequent to the time of contracting to disturb the allocation of unknown risks by the parties.

To date, a mere handful of reported decisions have dealt with the question of the independent efficacy of a consequential damage disclaimer upon the failure of the essential purpose of an exclusive remedy. The decisions seem to be in agreement with *County Asphalt*<sup>93</sup> that failure of the limited remedy does not mean automatic failure of the clause excluding liability for consequential damages. Beyond this, however, the courts have been obviously uncomfortable with the question. All of the cases involve situations in which there was a direct causal relationship between the failure of the remedy and the consequential damages suffered by the buyer. Moreover, in each case the court has concluded, correctly and unsurprisingly if the preceding analysis is correct, that to enforce the consequential damage exclusion would be unconscionable. Yet, in reaching this conclusion the courts have not proceeded upon the suggested analysis but have instead used several different and less persuasive bases for their decisions.

#### A. *Failure Due to Seller's Fault*

The most common basis used by the courts to strike a clause excluding the seller's liability for consequential damages upon failure of the essential purpose of an exclusive remedy is the fault or wrong-doing of the seller. If the seller has wilfully refused to perform the limited remedy or has been negligent or unreasonably dilatory in the performance of it, several courts have found that the buyer may recover for consequential losses irrespective of a disclaimer in the contract to the contrary. In *Adams v. J.I. Case Co.*<sup>94</sup> plaintiff purchased a crawler loader tractor for \$14,900 for use in his bulldozing business under a contract containing the standard repair or replace-

92. This causal relationship distinction is made with respect to incidental damages incurred by the buyer of a consumer product by the Magnuson-Moss Act, 15 U.S.C. § 2304(d) (Supp. V 1975).

93. *County Asphalt, Inc. v. Lewis Welding & Eng'r Corp.*, 323 F. Supp. 1300, 8 UCC Rep. Serv. 445 (S.D.N.Y. 1970), *aff'd*, 444 F.2d 372, 9 UCC Rep. Serv. 206 (2d Cir.), *cert. denied*, 404 U.S. 939 (1971); see text accompanying notes 81-88 *supra*.

94. 125 Ill. App. 2d 388, 261 N.E.2d 1, 7 UCC Rep. Serv. 1270 (1970).

ment warranty and excluding liability for consequential damages. The tractor developed serious defects, including a defective radiator which made the tractor dangerous to operate in moderate to high temperatures and a defective hydraulic system which rendered the tractor's bucket inoperable. The defects were brought to the attention of both the dealer and the manufacturer. Although the defects allegedly could have been repaired in about a week, the dealer kept the tractor for approximately three months giving it little or no attention for long periods of time. Plaintiff sued the dealer and the manufacturer for lost profits in excess of \$9,000 and repair costs of about \$600. The defendants moved to dismiss, arguing, *inter alia*, that plaintiff's action was barred by the terms of the contract. In ruling for the plaintiff the court found the consequential damage exclusion to have been a valid allocation of risks at the time of contracting but that a basic assumption of the parties at the time of contracting, that the dealer would honor the repair or replacement warranty in good faith, had failed, thereby rendering the exclusionary clause inoperable.<sup>95</sup> The court said:

[P]resumably the original limitation of liability was not unreasonable and from all that appears the plaintiff made his purchase with full knowledge of the limitations. But plaintiff could not have made his bargain and purchase with knowledge that defendants would be unreasonable, or in the words of his complaint, wilfully dilatory or careless and negligent in making good their warranty in the event of its breach . . . . It should be obvious that they cannot at once repudiate their obligation under their warranty and assert its provisions beneficial to them.<sup>96</sup>

In another "standard" 2-719(2) case the court took a similar stance. In *Jones & McKnight Corp. v. Birdsboro Corp.*<sup>97</sup> the plaintiff alleged that the defendant wilfully failed to correct the defects in the machinery, thereby causing plaintiff harm and, in particular, that "[d]efendant did not design and manufacture the machinery in a workmanlike manner, that it failed to take remedial action to redesign and remake the machinery and equipment when necessary under the purchase agreement, and that plaintiff's production was therefore seriously interrupted and impaired, causing plaintiff to suffer substantial losses."<sup>98</sup> The court quoted from the *Adams* decision and echoed that case by observing:

Although the plaintiff-buyer purchased and accepted the machinery and equipment with the apparent knowledge that the seller had properly limited its liability to repair or replacement, and although the plaintiff

95. Unfortunately the court went on to muddy its analysis by concocting, and finding defendants in breach of, an implied warranty for reasonably prompt and timely repairs. 261 N.E.2d at 8, 7 UCC Rep. Serv. at 1277. The court's reasoning stemmed from § 2-314(3) which provides: "Unless excluded or modified (Section 2-316) other implied warranties may arise from course of dealing or usage of trade." In inferring this warranty the court apparently went beyond the arguments of the plaintiff as well as the evidence presented at trial and ignored the disclaimer in the contract which stated that the repair and replacement warranty was "in lieu of all other warranties and conditions, express, implied or statutory." 261 N.E.2d at 6, 7 UCC Rep. Serv. at 1274. The court's reasoning is probably harmless, albeit confusing. The court would have been on sounder ground by simply citing 2-309(1) for the proposition that defendants had a duty to repair the defects within a reasonable time. See note 91 *supra*.

96. 261 N.E.2d at 7, 7 UCC Rep. Serv. at 1276.

97. 320 F. Supp. 39, 8 UCC Rep. Serv. 307 (N.D. Ill. 1970).

98. *Id.* at 40, 8 UCC Rep. Serv. at 309.

does not allege any form of unconscionability in the transactions which led to the purchase, plaintiff also was entitled to assume that defendants would not be unreasonable or wilfully dilatory in making good their warranty in the event of defects in the machinery and equipment. It is the specific breach of the warranty to repair that plaintiff alleges caused the bulk of the damages. This court would be in an untenable position if it allowed the defendant to shelter itself behind one segment of the warranty when it has allegedly repudiated and ignored its very limited obligations under another segment of the same warranty, which alleged repudiation has caused the very need for relief which the defendant is attempting to avoid.<sup>99</sup>

Given the cathartic effect of stamping out sin where and when we find it, the courts in these cases may simply have been grasping the most glaring inadequacy in the defendants' positions and using it as the basis of decision. In any enterprise in which one has to decide in favor of one side and against another, whether umpiring a sporting event, judging a beauty contest, or deciding a legal controversy, it helps immeasurably if one of the contestants has violated the rules. And it is almost irresistible to make the loser's machinations the basis for the result. Decisions based on sin are unconscionably self-satisfying and deceptively easy for the renderer; they punish the wrongdoer, and hopefully deter similar conduct in the future. Thus, it may well be that the courts in *Adams* and *Birdsboro Corp.* simply posited their decisions in what they believed to be the strongest terms. Possibly their decisions would have been the same regardless of the defendants' fault, the important factor being that the defendants' failure to perform the repair or replacement warranty caused the plaintiffs' consequential damages rather than the wilfulness, dilatoriness, or neglectfulness of that failure.<sup>100</sup>

Unfortunately, there are indications to the contrary.<sup>101</sup> In *Koehring Co. v. A.P.I., Inc.*,<sup>102</sup> another "standard" 2-719(2) case in which the seller alleged-

99. *Id.* at 43-44, 8 UCC Rep. Serv. at 313.

100. For what it is worth, earlier drafts of the Code made sellers' fault a proper, but certainly not an exclusive, consideration for avoiding a contractual exclusion of consequential damages. The 1941 Second Draft of the Revised Uniform Sales Act, which is a predecessor to present art. 2 of the Code, authorized consequential damage exclusions between merchants even for latent defects "if such defects are not due to avoidable fault on the part of the seller." NATIONAL CONFERENCE OF COMMISSIONERS AND UNIFORM STATE LAWS, REVISED UNIFORM SALES ACT—SECOND DRAFT § 57-A. The comment to § 57-A reasoned that it is not unreasonable for the risk of unknown and unavoidable defects to be allocated by a clearly particularized term. On the other hand, neither a general disclaimer of warranty nor a term limiting damages is ground for excusing a seller for a type of damage which good faith forbids such clauses to be read as including: a damage arising out of seller's avoidable fault, and out of buyer's reliance by the fact of taking delivery, on the absence of such fault.

*Id.* § 57-A, Comment (A)(2).

101. Indeed, the court in the *Birdsboro Corp.* case apparently insisted that on remand the plaintiff be able to prove that the defendant "lost its warranty protection of limited liability by repudiating its warranty obligation through wilfully dilatory action" 320 F. Supp. at 45, 8 UCC Rep. Serv. at 315 (emphasis added). But see *Ehlers v. Chrysler Motor Corp.*, 226 N.W.2d 157, 16 UCC Rep. Serv. 737 (S.D. 1975), for an interesting situation in which the automobile dealer's breach of the repair or replacement warrant was wilful, but perhaps in good faith. The dealer refused to repair buyer's automobile alleging that buyer had disconnected the odometer thereby relieving the dealer of its warranty obligations under the terms of the contract. On appeal, the court held for the buyer, refusing to disturb the jury finding that buyer had not disconnected the odometer.

102. 369 F. Supp. 882, 14 UCC Rep. Serv. 368 (E.D. Mich. 1974).

ly wilfully refused to repair or replace, the court declined to dismiss summarily defendant buyers' counterclaim and said:

One argument is that even if the plaintiff failed to repair or replace any product not meeting the specifications, the plaintiff's failure was not wilfully dilatory. *Although defendants might not be entitled to additional remedies if they fail to prove that plaintiff failed to repair and such failure was wilfully dilatory*, a determination of this issue cannot be made on a motion to dismiss as it concerns questions of fact.<sup>103</sup>

Moreover, there are cases which go one step further by holding that the exclusive remedy itself, much less the consequential damage exclusion, does not fail absent fault on the part of the seller.<sup>104</sup> Under this line of decisions the buyer is barred from all relief, including general as well as consequential damages. These cases, however, are against the weight of authority and as a general proposition are nonsensical. There is nothing in the text of 2-719(2) nor in the accompanying Official Comment which focuses on the fault of the seller. The question is whether an exclusive remedy has failed of its essential purpose or whether the buyer will be deprived of the substantial value of his bargain.

Further, as noted by the court in the *Koehring* case, the peg upon which liability actually hangs in these types of cases is the seller's breach of the limited repair or replacement warranty.<sup>105</sup> There is no more basic tenet in the law of contract than the proposition that one is liable for the breach of his promises, covenants, and warranties, regardless of his motive, good faith, or innocence. In a sense, and with few exceptions, breach of contract has always been a strict liability concept. Thus, the only situation in which the lack of fault or good faith of the seller should be relevant to the question of breach of his warranty is where, expressly or implicitly, the seller has warranted no more than his good faith effort. As suggested earlier<sup>106</sup> this kind of warranty would most likely validly appear in a contract for the sale of complex and highly experimental goods; under such circumstances the buyer may have willingly assumed all risks for incurable defects or inadequacies in the goods in return for the seller's promise to use his best efforts to correct the defects and inadequacies.

To date there have been no cases directly on point, but one close to the mark is *American Electric Power Co. v. Westinghouse Electric Corp.*<sup>107</sup> In that case the court made the following observation:

[T]he rule that the agreed-upon allocation of commercial risk should not be disturbed is particularly appropriate where, as here, the warranted

103. *Id.* at 890, 14 UCC Rep. Serv. at 378 (emphasis added).

104. See, e.g., *Potomac Elec. Power Co. v. Westinghouse Elec. Corp.*, 385 F. Supp. 572, 16 UCC Rep. Serv. 360 (D.D.C. 1974), *rev'd and remanded*, 527 F.2d 853 (D.C. Cir. 1975); *U.S. Fibres, Inc. v. Proctor & Schwartz, Inc.*, 358 F. Supp. 449, 13 UCC Rep. Serv. 254 (E.D. Mich. 1972), *aff'd*, 509 F.2d 1043, 16 UCC Rep. Serv. 1 (6th Cir. 1975); *Lankford v. Rogers Ford Sales*, 478 S.W.2d 248, 10 UCC Rep. Serv. 777 (Tex. Civ. App.—El Paso 1972, writ ref'd n.r.e.).

105. "In a sense, there are two breaches of the contract; the first being the failure to deliver goods conforming to the express warranty, and the second being the failure to correct the nonconformity as was promised in the party's [*sic*] agreement." 369 F. Supp. at 890, 14 UCC Rep. Serv. at 378.

106. See text accompanying notes 92-93 *supra*.

107. 418 F. Supp. 435, 19 UCC Rep. Serv. 1009 (S.D.N.Y. 1976).

item is a highly complex, sophisticated, and in some ways experimental piece of equipment. Moreover, compliance with a warranty to repair or replace must depend on the type of machinery in issue. In the case of a multi-million dollar turbine-generator, we are not dealing with a piece of equipment that either works or does not, or is fully repaired or not at all. On the contrary, the normal operation of a turbine-generator spans too large a spectrum for such simple characterizations.<sup>108</sup>

In *American Electric Power Co.* the plaintiff alleged a wilful refusal by defendant to honor the repair or replacement warranty and asked for direct and consequential damages. On the basis of the "highly complex, sophisticated, and . . . experimental" goods distinction, however, the court upheld the provision in the contract excluding consequential damages and granted the defendant's request for partial summary judgment with respect to such damages. In so doing, the court rendered the first, and to date only, decision upholding a separate consequential damage disclaimer under circumstances in which the seller had allegedly wilfully refused to honor the exclusive remedy warranty. This result is proper, and significant, if the court meant that enforcing the clause excluding consequential damages would not be unconscionable because the consequential damages suffered by the buyer were the result of the experimental nature of the goods and were thus not proximately caused by the seller's breach of the limited remedy warranty. This determination, however, could only be made by a finding that the defects were incurable by reasonable effort, a finding to which the court does not allude.<sup>109</sup>

With the exception of *American Electric Power Co.*, however, the courts have uniformly refused to give effect to a separate provision of the contract excluding liability for consequential damages where the seller has wilfully refused to honor the repair or replacement obligation. Unfortunately, in none of the cases, including *American Electric Power Co.*, has the court

108. *Id.* at 458, 19 UCC Rep. Serv. at 1030-31. Indeed, this may be the best basis for understanding the cases that hold that a limited repair or replacement remedy does not fail of its essential purposes despite the fact that the seller was unsuccessful in correcting the defects if the seller was acting in good faith. See note 104 *supra*. The *Potomac Electric Power Co.* case, like *American Electric Power Co.*, involved a complex turbine-generator, and *U.S. Fibres, Inc.* involved an experimental conveyor-oven. Thus, the courts may have been implicitly saying that the seller had in fact agreed only to use good faith best efforts to correct defects. If so, the *Lankford* case stands alone in requiring wilfulness or bad faith for an exclusive remedy to fail of its essential purpose under 2-719(2). *Lankford* involved that classic type of standardized and non-experimental good, the American automobile. A close reading of *Lankford* may, however, reveal it to be distinguishable on other facts. Instead of simply pleading that the various dealers' inability to cure defects in the automobile caused the exclusive repair or replacement remedy to fail of its essential purpose, plaintiff: (1) admitted the defects had been corrected as they occurred; (2) alleged no dilatoriness, carelessness, or negligence on the part of the dealers in complying with the limited warranty; and (3) most unfortunately, pitched his claim on the theory that since the exclusive remedy had failed of its essential purpose he should be allowed to recover on the basis of breach of the implied warranties of merchantability and fitness for particular purpose notwithstanding the fact that these warranties had been effectively disclaimed. Thus, *Lankford* may simply be a case in which a court faced the difficult task of applying unhelpful, ineffective, and confusing pleadings to a difficult statutory formulation at a time when there was little authority from other courts upon which to rely.

109. In fact, since plaintiff had alleged that defendant had wilfully refused to repair, the court held that there were material issues of fact as to whether the exclusive remedy had failed of its essential purpose. Accordingly, the court denied defendant's motion for summary judgment on plaintiff's claims for breach of express warranties. Thus, the complex and experimental nature of the goods insulated seller from consequential, but not general, damages if seller's fault resulted in the exclusive remedy failing of its essential purpose.



properly focused its analysis on the causal relationship between the seller's breach and the consequential damages suffered by the buyer. Although that relationship may have been present in *Adams, Birdsboro Corp.*, and *Koehring*, and lacking in *American Electric Power Co.*, so that the result was proper in all cases, the misfocused analysis by the courts presents a red herring in the form of the seller's fault which may encourage improper results in the future. Care must be taken that these cases not be read so cursorily as to absolve all innocently breaching sellers from liability for the consequential damages they cause and to hold all wilfully breaching sellers liable for consequential damages, including those which they may not have caused. The proper focus for analysis is on the contemplation of the parties when the risk of consequential damages was allocated to the buyer, on whether the seller's unwillingness or inability to perform the limited remedy warranty caused the buyer's consequential losses, and on whether that causation, if present, sufficiently goes against the contemplations of the parties that it would be unconscionable to leave the risk allocation of consequential damages on the buyer.

**B. Failure Due to Good Faith Inability to  
Repair or Failure Even Though the  
Seller Repaired in Good Faith**

There are cases which eschew the seller's fault as a basis for determining whether consequential damages are allowable upon failure of the essential purpose of an exclusive remedy. In at least two cases the courts have allowed the buyer to recover consequential damages without having to show that the seller wilfully breached the exclusive remedy warranty or that the seller was negligent or dilatory in the attempted performance of it. In *Beal v. General Motors Corp.*<sup>110</sup> plaintiff had purchased an extra-heavy tonnage diesel tractor under a contract limiting the liability of the dealer and the manufacturer to repair and replacement of defective parts. Plaintiff alleged that General Motors was "unable or willing"<sup>111</sup> to correct a host of defects so as to make the vehicle operable. The "major legal issue"<sup>112</sup> presented was whether these allegations, if proven, would entitle the plaintiff to recover consequential damages. Defendant had moved to strike plaintiff's allegations with respect to consequential damages for failure to state a claim upon which relief could be granted. The court held for the plaintiff, refused defendant's motion to strike, and remanded the case. The court reasoned that, assuming a "proper case" was made for plaintiff's recovery of consequential damages,<sup>113</sup> if defendant had breached the limited repair or replacement warranty by its inability to correct the defects, the limited remedy failed of its essential purpose and plaintiff would be entitled to recover not only direct but consequential damages as well.

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110. 354 F. Supp. 423, 12 UCC Rep. Serv. 105 (D. Del. 1973).

111. *Id.* at 425, 12 UCC Rep. Serv. at 107.

112. *Id.*, 12 UCC Rep. Serv. at 108.

113. The court was referring to 2-714(3) which provides that "[i]n a proper case any incidental and consequential damages under the next section may also be recovered." To present a proper case under 2-715, such damages must have been foreseeable to the seller and not avoidable by the buyer. *See* U.C.C. § 2-715(2).

The *Beal* case presents a number of striking, and perhaps significant points. First, in reaching its decision that the limited remedy warranty would not bar the plaintiff's claim for consequential damages, the court was wholly unconcerned with whether the failure of the exclusive remedy was due to the seller's fault or simply to an inability to perform. Secondly, in tune with the other courts which have faced the question, the court evidenced no interest either in whether there was a causal connection between the seller's breach of the limited remedy warranty and the consequential damages suffered by the buyer, or in the basic assumptions of the parties at the time of contracting in allocating the risk of consequential loss to the buyer. Thirdly, in light of these first two points, the case can be read as standing for the proposition that in any situation in which an exclusive remedy fails of its essential purpose a consequential damage excluder will not bar recovery. That proposition is, of course, wrong. The standard for efficacy of a provision excluding liability for consequential damages is unconscionability, purely and unsimply. Although the failure of the essential purpose of an exclusive remedy may be relevant to the question of unconscionability in this context, such failure is not determinative of it.<sup>114</sup>

If *Beal* is read as holding that an automatic determination of unconscionability is found upon failure of essential purpose of a limited remedy, then it stands apart in its analysis from all other cases heretofore discussed. But *Beal* also stands apart from these other cases with respect to one minor, unarguably insignificant, arguably irrelevant, albeit perhaps determinative, fact. In *Beal* there was no separate provision in the contract excluding liability for consequential damages. The manufacturer warranted to repair or replace defective parts for a limited period, limited the buyers' remedy to repair or replacement, disclaimed all other express or implied warranties, but made no explicit mention of consequential damages.<sup>115</sup> Now unquestion-

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114. See text accompanying notes 73-93 *supra*.

115. The contract provided:

10. There are no warranties, expressed or implied, made by either the Dealer or the Manufacturer on new GMC motor vehicles, chassis or parts furnished under this Order except the Manufacturer's Warranty against defects in material and workmanship set out below:

GMC Truck & Coach Division of General Motors Corporation, as Manufacturer, warrants each new motor vehicle and chassis including all equipment and accessories thereon (except tires and tubes) manufactured or supplied by GMC Truck & Coach Division and delivered to the original retail purchaser by an authorized GMC Truck Dealer, to be free from defects in material and workmanship under normal use and service; GMC Truck & Coach Division's obligation under this warranty being limited to repairing or replacing at its option any part or parts thereof which shall, within twenty-four (24) months after delivery of such vehicle or chassis to the original retail purchaser or before such vehicle or chassis has been driven twenty-four thousand (24,000) miles, whichever event shall first occur, be returned to an authorized GMC Truck Dealer at such Dealer's place of business and which examination shall disclose to Manufacturer's satisfaction to have been thus defective. The repair or replacement of defective parts under this warranty will be made by such Dealer without charge for parts, and if made at such Dealer's place of business, without charge for labor.

354 F. Supp. at 425, 12 UCC Rep. Serv. at 107. Perhaps the court did not quote all pertinent parts of the contract, but without doubt any provision referring to consequential damages would have been included since the court labeled the recovery of such damages the "major legal issue presented." For examples of cases involving specific contractual provisions excluding liability for consequential damages, see note 120 *infra*.

ably such a formulation has the effect of excluding liability for such damages and the court expressly recognized this fact in stating, "[t]he purpose of an exclusive remedy of replacement or repair of defective parts, the presence of which constitute a breach of an express warranty, is to give the seller an opportunity to make the goods conforming while limiting the risks to which he is subject by excluding direct and consequential damages that might otherwise arise."<sup>116</sup>

Nevertheless, the absence of a particularized excluder of consequentials may well have misfocused the court's perception of the central issue: the independence or dependence of the parties' "allocation of unknown or undeterminable risks."<sup>117</sup> Once the court had expunged the limited repair or replacement warranty for failure of essential purpose, what was left to exclude liability for consequential damages? Nothing, if the court accomplished the expurgation by reading the limited warranty out of the contract. In this light, the court's slipping into the following reasoning is understandable.

Defendant concedes that plaintiff is entitled to direct damages measured by market values. What is it, however, that gives him this remedy? It is clearly not the contract, for it purports to substitute a right of replacement and repair for any right to damages. Rather, the right to direct damages arises from § 2-714(2) of the Uniform Commercial Code. But where the parties expressly provide for an exclusive remedy 'in substitution for' the 'measure of damages recoverable under' the Code, that remedy is the buyer's sole recourse. § 2-719. The direct damage remedy of § 2-714(2), therefore, is applicable only when the exclusive remedy provided in the contract fails of its essential purpose within the meaning of § 2-719(2). Under that section when such a failure occurs recourse may be had to all the remedial provisions of the Code. There is no discernible reason for limiting that recourse to selected remedial provisions as defendant apparently attempts to do. The direct damages section, § 2-714(2), has no greater claims to application here than does the consequential damages section, § 2-714(3), assuming, of course, that this is otherwise 'a proper case' for consequential damages.<sup>118</sup>

If, however, the contract had included a separate limiting provision, that fact might well have given the court a "discernible reason for limiting . . . recourse to selected remedial provisions"; the lack of such a clause may well have obscured the issue. The lesson of the *Beal* case, then, may be simply one for the draftsman. Although such interpretive analysis may indeed be "in the worst 'draftsman-hit-me-again' tradition"<sup>119</sup> and beyond

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116. 354 F. Supp. at 426, 12 UCC Rep. Serv. at 109.

117. See U.C.C. § 2-719, Comment 3.

118. 354 F. Supp. at 427, 12 UCC Rep. Serv. at 110. The text of § 2-714 can be found at note 89 *supra*. Cf. *Gramling v. Baltz*, 485 S.W.2d 183, 10 UCC Rep. Serv. 1121 (Ark. 1972), wherein the contract provided that seller's repair or replacement warranty was "in lieu of" liability for consequential damages. The court allowed the buyer's recovery of consequential damages, reasoning under the wording of the contract that once the repair or replacement warranty failed of its essential purpose there was nothing to stand "in lieu of" the buyer's recovery of consequential damages.

119. *Ellinghaus*, *supra* note 17, at 802 n.209. But consider, for example, that line of cases which holds in a related context that a warranty disclaimer will not bar recovery for claims sounding in negligent breach of contract unless the disclaimer specifically mentions "negligence," "tort," or their cognates. See, e.g., *Berwind Corp. v. Litton Indus., Inc.*, 532 F.2d 1 (7th Cir. 1976). But for a case of interpretive analysis run amuck see *Ford Motor Co. v. Reid*,

the expressed reasoning of the court, other courts which have upheld the independence of a consequential damage exclusion upon the failure of the essential purpose of a limited remedy have gone to great lengths to point out that the exclusion was expressly provided for by a separate clause of the contract.<sup>120</sup>

The second case, alluded to earlier, which eschews the wilfulness standard for finding a consequential damage exclusion dependent upon the seller's honoring the limited repair warranty is *Reynolds v. Preferred Mutual Insurance Co.*<sup>121</sup> In *Reynolds*, as in *Beal*, there was no separate provision excluding liability for consequential damages. *Reynolds* involved a contract for the sale and installation of rain gutters on plaintiff's house. The contract contained the following remedy limitation warranty:

Contractor will do all said work in a good workmanlike manner. Upon written notification from the owner of a defect in workmanship or material, the contractor will repair the same if such a defect exists but in no event shall the contractor be liable beyond the cost to it of labor and materials.<sup>122</sup>

250 Ark. 176, 465 S.W.2d 80, 8 UCC Rep. Serv. 985 (1971), wherein the court allowed the buyer over \$89,000 in consequential damages. The court reasoned that, although Ford's warranty limited its "obligations" to repair or replacement of defective parts, it did not limit the buyer's "remedies." "Remedies are not 'obligations,' they are rights arising from failure to perform obligations," said the court. 465 S.W.2d at 85, 8 UCC Rep. Serv. at 991. Since buyer's remedies were not limited, § 2-719 was not applicable and buyer could recover under the general remedial provisions of the Code.

In a different context Professor Karl Llewellyn, the primary author of article 2 of the Uniform Commercial Code, once stressed the importance of careful draftsmanship as follows:

In the normal modern case the first measure of the parties' rights is . . . the contract . . . , only an analysis which stresses the contract first and hammers on the necessity of keeping it in mind as the framework of all that follows, is adequate to teaching. . . . [O]nly by emphasis, from the beginning, on the contract, can one bring to due honor the problem of draftsmanship . . . .

K. LLEWELLYN, CASES AND MATERIALS ON THE LAW OF SALES xiv-xv (1930).

Most significantly, the Federal Trade Commission Regulations to the Magnuson-Moss Act require that any limitation or exclusion of consequential (or incidental) damages be conspicuous in the contract. 16 C.F.R. § 701.3(a)(8) (1977). The Regulations extend this requirement to consumer products costing more than \$15.00. The Act itself requires only of "full" warranties that clauses excluding or limiting consequential damages be conspicuous. 15 U.S.C. § 2304 (a)(3) (Supp. V 1975). See note 18 *supra*.

120. "This court would be in an untenable position if it allowed the defendant to shelter itself behind one segment of the warranty when it has allegedly repudiated and ignored its very limited obligations under another segment of the same warranty . . . ." *Jones & McKnight Corp. v. Birdsboro Corp.*, 320 F. Supp. 39, 43, 8 UCC Rep. Serv. 307, 313 (N.D. Ill. 1970). "A better reading is that the exclusive remedy clause should be ignored; other clauses limiting remedies in less drastic manner and on different theories would be left to stand or fall independently of the stricken clause." *County Asphalt, Inc. v. Lewis Welding & Eng'r Corp.*, 323 F. Supp. 1300, 1309, 8 UCC Rep. Serv. 445, 448-49 (S.D. N.Y. 1970), *aff'd on other grounds*, 444 F.2d 372, 9 UCC Rep. Serv. 206 (2d Cir.), *cert. denied*, 404 U.S. 939 (1971). "[T]here is no reason to disturb the consensual allocation of business risk embodied in the . . . contract. One provision of that contract contains defendant's warranty to repair or replace defective parts. A totally separate provision expressly limits the defendant's liability such that special or consequential damages may not be recovered." *American Elec. Power Co. v. Westinghouse Elec. Corp.*, 19 UCC Rep. Serv. 1009, 1030 (S.D. N.Y. 1976). "The *County Asphalt* holding has merit as the consequential damages clause was separate and independent from the repair and replacement clause." *Koehring Co. v. A.P.I., Inc.*, 369 F. Supp. 882, 890, 14 UCC Rep. Serv. 368, 377 (E.D. Mich. 1974). See also *Kolenburger, Inc. v. Tyson's Foods, Inc.*, 256 Ark. 584, 510 S.W.2d 555, 14 UCC Rep. Serv. 1281 (1974); *Adams v. J.I. Case Co.*, 125 Ill. App. 2d 388, 261 N.E.2d 1, 7 UCC Rep. Serv. 1270 (1970); *Ehlers v. Chrysler Motor Corp.*, 226 N.W.2d 157, 16 UCC Rep. Serv. 737 (S.D. 1975).

121. 11 UCC Rep. Serv. 701 (Mass. App. Div. 1972).

122. *Id.* at 703.

The gutters were negligently installed, resulting in water damage to the plaintiff's house. Yet the defendant was not only ready, willing, and able to correct the defects in the installation of the gutters, it did so in a reasonable manner. Nevertheless, the court allowed recovery of \$1,759 as consequential damages for water damage to plaintiff's house.

In reaching this result the court apparently recognized that the contractor's limited warranty sought to exclude consequential damages, and that the standard for judging such a provision is unconscionability under 2-719(3). Although the court found no evidence of unconscionability at the inception of the contract,<sup>123</sup> it nevertheless went on to say:

However, § 2-719(2) is also pertinent. The Uniform Commercial Code Comment to this section states that where an apparently fair and reasonable clause, because of circumstances, fails in its purpose or operates to deprive either party of the substantial value of the bargain, it must give way to the general remedy provisions of this Article. The limitation of remedy in this agreement must, therefore, be tested at the time of Certified's breach. If the original plaintiff were made whole by the correction of the defective workmanship or material, then she would have the benefit of her bargain.

The court found that the damages to her real property because of Certified's breach amounted to \$1,759.00. The correction of the defect without compensating the plaintiff for her loss, deprived her of the 'substantial value of the bargain'; thus, the remedy failed of its essential purpose.<sup>124</sup>

Clearly, under this reasoning, failure of essential purpose and the failure of a consequential damage exclusion will coexist whenever significant consequential damages are suffered by a buyer; otherwise the buyer would not be compensated for the loss and, thus, would be deprived of the substantial value of the bargain. In reaching its result, the court disregarded the fact that the risk of consequential loss was allocated to the buyer by the contract. Moreover, the decision cannot be explained on the basis of unconscionability and adhesion contract principles or on the basis of the consumer context. The court expressly found against the former<sup>125</sup> and bypassed a lovely opportunity to decide the case in terms of the latter.<sup>126</sup> If, however, the contract had provided in a separate provision for the exclusion of conse-

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123. When it is claimed or appears to the court that the contract or any clause thereof may be unconscionable the parties shall be given a reasonable opportunity to present such evidence. This is a condition precedent which must be met prior to the trial court's determination of this issue. There is no evidence in the record satisfying this requirement, therefore, we cannot rule on this point at this time.

*Id.* at 707-08.

124. *Id.* at 708.

125. See note 123 *supra*.

126. Some nineteen months after the contract in question was entered into the Massachusetts legislature enacted consumer legislation which rendered "any attempt to exclude or modify any implied warranties of merchantability and fitness for a particular purpose or to exclude or modify the consumer's remedies for breach of those warranties . . . unenforceable." 11 UCC Rep. Serv. at 706. Plaintiff unsuccessfully argued that this legislation should be given retroactive effect. The court ruled that: "In the absence of clear statutory language, legislation affecting substantive rights is not retroactive." *Id.* Even if the court felt bound by prevailing precedent to deny the legislation retroactive effect, the legislation nevertheless armed it with a broad based opportunity to enforce the spirit of the legislation or to apply it by analogy. The court, however, made no further reference to the transaction as a consumer contract.

quential damages, the court might have given the provision separate treatment and more properly directed its attention to the risk allocation at the time of contracting and to the presumptions of the parties in making that allocation.

### C. *Latent Defects Revisited*

In at least one class of cases the failure of the essential purposes of an exclusive remedy should entitle the buyer to consequential as well as general damages regardless of whether the contract contains a separate consequential damage disclaimer. Such a case is presented by the latent defect paradigm as exemplified in *Wilson Trading Corp. v. David Ferguson, Ltd.*<sup>127</sup> As suggested earlier, if the court was correct in analyzing the case under the standards of 2-719(2) it must have implicitly assumed that the clause barring claims by the buyer for defects in the yarn made after ten days of receipt or after processing was valid at the time of contracting. Under this reasoning, the failure of the clause must have been attributable to the fact that the parties had not intended it to cover latent defects. Thus, the risk of occurrence of such defects had not been allocated to the buyer and the subsequent discovery of such defects represented "novel circumstances not contemplated by the parties."<sup>128</sup> Accordingly, giving effect to the clause would deprive the buyer of the substantial value of the bargain by forcing it to suffer substantial losses which it had not agreed to assume. This analysis holds true whether these unallocated losses were in the form of general damages for a decreased value of the yarn or consequential damages for lost profits on the resale of that yarn.<sup>129</sup>

Another interesting case on point is *Neville Chemical Co. v. Union Carbide Corp.*<sup>130</sup> The facts are strikingly similar for our purpose to those in *Wilson Trading*. Neville Chemical Co. had been purchasing from Union Carbide for several years a product known as "resin former oil" which had been given the grade or designation "U-171." The product had been developed to meet Neville's particular requirements. Neville used U-171 in the production of resins for sale to its customers, who in turn used the resins in the manufacture of various products, including floor tiles, shoe soles, and paper coatings. The contract between Neville and Union Carbide barred claims made later than fifteen days after delivery, disclaimed all liability for results obtained from the use of the product in the manufacturing process, and exclusively limited Neville's remedy for defects in the product to a return of the purchase price. Performance under this contract went on for several years without event. Then, for some unexplained reason, Union Carbide, without advising Neville, changed its manufacturing process for the resin former oil so as to allow a contaminant known as "ethyl acrylate" into the product. Soon thereafter Neville began receiving numerous com-

127. For a discussion of the case see notes 30-44 *supra* and accompanying text.

128. REPORT OF THE NEW YORK LAW REVIEW COMMISSION, *supra* note 16, at 584; see text accompanying note 26 *supra*.

129. This assumes, of course, that a "proper case" is otherwise made for the recovery of consequential damages. See U.C.C. §§ 2-714(3), 2-715(2)(a).

130. 294 F. Supp. 649, 5 UCC Rep. Serv. 1219 (W.D. Pa. 1968), *aff'd in part, rev'd in part*, 422 F.2d 1205, 7 UCC Rep. Serv. 81 (3d Cir.), *cert. denied*, 400 U.S. 826 (1970).

plaints from its customers to the effect that the products made from the resins prepared with U-171 had begun to emit a persistent and intolerable odor, and, in many cases, had to be destroyed. The primary claim by Neville against Union Carbide was for consequential damages. On appeal, the district court affirmed the trial court's decision in favor of Neville, holding that the occurrence of latent defects, defects "not discoverable by ordinary inspection and testing,"<sup>131</sup> rendered the time limitation clause manifestly unreasonable under section 1-204 of the Code<sup>132</sup> and caused the exclusive remedy of return of the purchase price to fail of its essential purpose under section 2-719(2).<sup>133</sup>

On the basis of our discussion to this point, it seems that Neville had a lock on its recovery of consequential damages. There was no separate clause in the contract excluding such liability; the seller was at fault in changing the production process without the buyer's permission and without notifying the buyer; and the defects giving rise to buyer's losses were latent. Nevertheless, although the lack of a separate clause excluding consequential damages may as a practical matter have caused some courts to misfocus their analysis, it is abject silliness to use the absence of such a clause as a basis for analysis in exclusive remedy cases. An exclusive remedy provision serves two functions: it limits the affected party's recourse for direct damages and it bars claims for consequential damages. The Code provides independent standards for judging the efficacy of such a clause in terms of each of these purposes. Further, an occurrence of latent defects cannot in itself be a bridge over exclusive remedy limitations or clauses excluding consequential damages. The proper initial inquiry is whether the buyer has been allocated under the terms of the contract the risk of losses which may occur from such defects. If the buyer has not been allocated this risk then it remains on the seller<sup>134</sup> and enforcement of any clause excluding the seller's liability for consequential damages would be unconscionable.

In *Neville Chemical*, however, it would appear that Neville had accepted the risk of losses resulting from latent defects. The U-171 resin former oil was rather experimental in nature and was geared to Neville's particularized requirements. Thus, the contract provided that: "Buyer assumes all risk and liability for the results obtained by the use of the material delivered hereun-

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131. *Id.* at 655, 5 UCC Rep. Serv. at 1224.

132. See the text of U.C.C. § 1-204(1) quoted at note 35 *supra*.

133. The Third Circuit affirmed the district court's decision for Neville on the liability issues solely on the basis that the disclaimer and remedy limitation clauses did not relieve Union Carbide from responsibility for negligence.

134. Under the presumption that the seller would be best able to discover the risk and thus avoid or prevent the loss. Very rare indeed would be a defect that, albeit latent, is undiscoverable. A situation which comes close is the case of mislabeled seeds for some crops prior to the time that the seeds are planted and the crops begin to grow. Even here, however, the seller could have avoided the loss before the mislabeling occurred, whereas the buyer had no opportunity to avoid the loss. There is a close correlation between latent defects and loss avoidance. Thus, although employing divergent theories, the courts impose liability on the seller in seed defect cases with a high degree of regularity. See *Dessert Seed Co. v. Drew Farmers Supply, Inc.*, 248 Ark. 858, 454 S.W.2d 307, 7 UCC Rep. Serv. 995 (1970); *Klein v. Asgrow Seed Co.*, 246 Cal. App. 2d 87, 54 Cal. Rptr. 609, 3 UCC Rep. Serv. 934 (1966); *Q. Vandenberg & Sons v. Siter*, 204 Pa. Super. Ct. 392, 204 A.2d 494, 2 UCC Rep. Serv. 383 (1964). A number of pre-Code seed warranty cases are collected in Fuller & Perdue, *The Reliance Interest in Contract Damages: I*, 46 YALE L.J. 52, 92 n.64 (1936).

der in manufacturing process of Buyer or in combination with other substances."<sup>135</sup> Further, there was nothing in either the reported facts or in the district and circuit courts' opinions to indicate that the allocation of the risk of latent defects to the buyer at the inception of the contract was unconscionable. Nevertheless, the courts' decisions in favor of Neville were undoubtedly correct. Subsequent circumstances attributable to fault on the part of the seller had intervened during the performance of the contract. Union Carbide unilaterally, and without notifying Neville, changed the production process by introducing a contaminant into U-171 which directly caused Neville's losses. Thus, as in the limited repair or replacement remedy cases the losses suffered by the buyer were directly attributable to the seller's wrongdoing. Under such circumstances, enforcing a clause which excludes the seller's liability for consequential damages would be unconscionable. When the buyer accepted the allocation of the risk of such losses, it did so on the basis of known facts and, in particular, under the presumption that the seller would not actively engage in a course of conduct calculated to cause injury. When that presumption failed, the clause on which it was based failed with it.<sup>136</sup>

In sum, when a buyer has not at the time of contracting agreed to assume responsibility for latent defects in the goods, the subsequent occurrence of such defects should render unenforceable not only clauses limiting the remedial recourse of the buyer but clauses excluding the seller's liability for consequential damages as well. This result is proper since the seller is in a better position than the buyer to discover and thus avoid such defects.<sup>137</sup> If, however, the contract allocates the risk of latent defects in the goods to the buyer, such clauses should stand, absent independent grounds for challenging their efficacy. In *Neville Chemical* the seller's fault was properly found to be such a ground.

### III. SUMMARY AND CONCLUSION

This Article has focused primarily on two important questions arising under section 2-719 of the Uniform Commercial Code. First, under what circumstances have the courts found an exclusive remedy to have failed of its essential purpose so as to give way to the general remedy provisions of article 2? Secondly, once an exclusive remedy has failed, is the aggrieved party entitled to consequential as well as general damages?

With respect to the first question, all of the reported decisions can be categorized under two paradigms: (1) the latent defect paradigm involving the appearance of latent defects in the goods which are not discoverable upon receipt of shipment and reasonable inspection; (2) the "standard" 2-

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135. 294 F. Supp. at 654, 5 UCC Rep. Serv. at 1223.

136. Further, this analysis emphasizes the close correlation between liability for latent defects and the ability to avoid the consequences of such losses. Union Carbide, but certainly not Neville, could have avoided the losses resulting from its unilateral change in the manufacturing process. See note 134 *supra*.

137. In cases where the buyer would be in a better position to avoid the defect, the defect presumably would not be properly termed "latent."



719(2) paradigm, involving situations in which the seller or other party is required to provide a remedy but, by its action or inaction, has caused the remedy to fail.

The discussion of the latent defect paradigm emphasized that 2-719(2) is concerned with clauses which were valid at the inception of the contract but which failed due to subsequent intervening circumstances arising from the performance of the contract. Accordingly, for intervening latent defects to cause the remedy limitation to fail it must be found that the aggrieved party had not been allocated by the contract the risks associated with such defects. If no such allocation had been made then the occurrence of latent defects may well have deprived the affected party of the substantial value of the bargain. The Official Comments to section 2-719 and a consistent line of judicial decisions make it clear that substantial bargain deprivation is proper cause for an exclusive remedy to fail of its essential purpose under 2-719(2).

The second paradigm has become so common in the reported decisions and so closely tracks the language of 2-719(2) as to deserve the appellation "standard." When a seller has provided an exclusive remedy under the contract of sale and that remedy, through the fault of the seller or otherwise, fails to correct either defects in the goods or other deviations from performance by the seller so as to deprive the buyer of the substantial value of his bargain, the courts as a matter of course have held that the remedy has failed of its essential purpose. Pursuant to the dictates of 2-719, the courts have then held that the contractual remedy must give way to the general remedial provisions of article 2.

Under both paradigms, however, courts have largely ignored the textual language of 2-719 and have instead concentrated on the standard provided by the Official Comments, *i.e.*, that an exclusive remedy should not be allowed to operate so as to deprive the affected party of the substantial value of the bargain. In so doing the courts have been remarkably inarticulate in explaining what essential purpose of the exclusive remedy has failed. The unspoken assumption, however, seems to be that exclusive remedies are generally intended from the seller's viewpoint to limit the seller's liability for direct damages by allowing it an opportunity to correct the defects and to exclude consequential damages, and, from the buyer's viewpoint, to give the buyer goods that conform to the contract within a reasonable time after a defect has become apparent.

Clearly, the more important of the two questions addressed by this Article is whether upon failure of an exclusive remedy the buyer should be entitled to recover consequential as well as general damages. Contractual provisions excluding liability for consequential damages take two forms: (1) clauses which seek to accomplish the exclusion directly by specific provision; (2) clauses such as exclusive remedy provisions which do not mention consequentials but accomplish their exclusion indirectly by relegating the buyer's recourse to the exclusive remedy. Subsection 2-719(3) is reasonably straightforward in establishing *unconscionability* as the operative criterion for judging the efficacy of both types of clauses. Thus it follows that the failure of an exclusive remedy should not in and of itself require a clause

which excludes liability for consequential damages to be held unenforceable. Under the terms of the contract the buyer has been allocated the unknown or undeterminable risks of consequential loss; the question thus becomes whether, because of the failure of the exclusive remedy, it would be unconscionable for consequential loss to be left on the buyer. This Article suggests that such unconscionability may be argued only in those cases in which the seller's breach of the limited warranty has directly caused the buyer to suffer consequential damages beyond those which the buyer has agreed to assume. In such circumstances a basic assumption of the parties in allocating the risk of consequential damages to the buyer has been rendered inoperative. The parties must have assumed that the seller's performance under the limited remedy provision would subject the buyer to no more than a closed-ended risk of consequential loss. The intervening circumstance of the seller's inability to perform under the warranty provision has directly caused the buyer to suffer open-ended consequential damages which the buyer had not agreed to assume. On the other hand, if the seller's breach of warranty has not actually subjected the buyer to consequential damages beyond those which the buyer had agreed to assume, there is no reason to disturb the parties' allocation of risk. In such cases, leaving the buyer with responsibility for consequential damages merely enforces the bargain which was made.

The results in the reported decisions are consistent with this analysis. Nevertheless, in reaching their decisions the courts have not plainly articulated their reasoning and have used several less persuasive bases for decision. First, the courts have regularly held that if the seller wilfully refused to honor the repair or replacement warranty, the clause excluding liability for consequential damages fails with the exclusive remedy. Using the seller's fault as a criterion for efficacy in this context is unarguably correct and is simply a corollary of the analysis suggested by this Article. That the seller would wilfully ignore its responsibilities under the limited remedy warranty was certainly beyond the contemplation of the parties at the time of contracting and would represent an intervening circumstance which would render inoperative a basic assumption of the parties in allocating the risk of consequential damages to the buyer. The buyer was entitled to assume that the seller would exercise good faith in performing its warranty obligations. If the seller's failure to so act has given rise to consequential damages beyond those which the buyer had agreed to assume, it would be unconscionable to read a provision in the contract so as to deny the buyer a right of recovery for that loss.

Secondly, some cases allow the buyer to recover consequential damages upon the failure of the essential purpose of an exclusive remedy even though there is no showing that the failure was due to wilfulness, dilatoriness, or negligence on the part of the seller. These decisions likewise evidence no inquiry as to whether the seller's breach gave rise to consequential damages beyond those which the buyer had agreed to assume. In fact, these decisions could be read to stand for the proposition that a failure of the essential purpose of an exclusive remedy automatically results in the failure of a

consequential damage exclusion. Reading these cases through a looking glass darkly, however, suggests that the courts may have been misled into misfocusing their analysis by the fact that there was no separate clause in the contracts in question specifically excluding liability for consequential damages. If so, these courts simply overlooked the critical fact that the exclusive remedy provision itself had the additional purpose and effect of allocating the risk of consequential loss to the buyer. Subsection 2-719(3) requires a separate analysis under a separate standard in judging the efficacy of the limited remedy provision for this purpose.

Finally, in at least one class of cases the failure of the essential purpose of the limited remedy should result as a matter of course in the allowance of a consequential damages recovery by the buyer. Under the latent defect paradigm, where the risk with respect to latent defects has not been allocated by the contract to the buyer and accordingly has remained on the seller, the subsequent occurrence of such defects should cause the failure of the essential remedy if the buyer would otherwise be deprived of the substantial value of the bargain. In such circumstances the clause excluding liability for consequential damages should fail as well because the parties did not contemplate that the buyer would assume the risk of consequential loss arising from latent defects.

In conclusion, the factual contexts in which the case law has developed are far more illuminating to an understanding of the metaphysics of 2-719(2) than the reasoning put forth by the courts. Nevertheless, it is unrealistic, and probably wrong, to hope that the courts will begin to frame their analysis in terms of the amorphous and rather meaningless text of 2-719(2)—to begin spouting the abstract silliness of exclusive remedies failing of essential purposes. It is much more sensible and sensical to formulate 2-719(2) analysis in terms of the proposition that subsequent intervening circumstances will render initially valid remedy limitations inoperative if such circumstances were beyond the contemplation of the parties at the time of contracting and will deprive the affected party of the substantial value of the bargain.

On the other hand, the courts do need to refocus their analysis with respect to the question of whether the buyer should be allowed recovery of consequential damages upon failure of an exclusive remedy. Undoubtedly, in most cases such recovery should be had by the buyer and this probably explains the correctness of the court decisions to date. Nevertheless, the applicable Code provisions do not provide *ipso facto* for consequential recovery upon the failure of an exclusive remedy. The margin for error in future cases can be effectively reduced only if the courts begin clarifying the bases of decision by focusing on the risk allocation by the parties at the time of contracting and on whether the failure of the exclusive remedy has caused consequential loss beyond that which the buyer had agreed to assume.